

**BEFORE THE
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Computer Reservations System Regulations, Notice of Proposed Rulemaking	: :	OST-1997-2881 OST-1997-3014 OST-1998-4775 OST-1999-5888
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COMMENTS OF AMERICAN AIRLINES, INC.

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COMMENTS OF AMERICAN AIRLINES, INC.

American Airlines, Inc. hereby submits comments on the Department's Notice of Proposed Rulemaking on computer reservations system (CRS) regulations, 67 Fed. Reg. 69365, November 15, 2002, and 67 Fed. Reg. 72869, December 9, 2002.

I. Introduction

American applauds much of the regulatory reform in the Department's NPRM. These reforms are being considered at a time when the airline industry is confronting unprecedented financial challenges, new and more efficient distribution channels are growing, and CRSs have become increasingly aggressive in their efforts to prevent these developing channels from disciplining excessive bookings fees. Airlines and their distribution systems are at a critical juncture, making time for concluding this rulemaking of the essence. American urges the Department to implement these needed regulatory reforms quickly.

As they have in the past, the CRSs can be expected to expend vast resources trying to slow down the regulatory process and to protect their market power. CRSs still exert market power against the traditional carriers, and that market power has continuing adverse implications for airline competition. A recent New York Times article reports that even in the airlines' current financial crisis, CRSs are doing "amazingly well."¹ CRSs have offset falling booking volumes with price increases. The article notes Sabre's self-described strategy of exploiting the "reservations business, a cash cow, for as long as [it] can." As recently as last month, at a time when airlines are fighting for survival, all of the CRSs raised booking fees.

The undiminished ability of every CRS to price against the economic tide, without losing airline participants, can only be explained by the fact that CRS market power is still very much intact. In the short to medium term, most airlines

¹ Saul Hansell, *Even as the Big Airlines Struggle, Computer Booking System Prospers*, N.Y. Times, February 9, 2003 (attached as Exhibit 1).

still have no choice but to participate in every CRS. Thus, the Department is not confronting the question of whether CRSs still have market power, but rather what role, if any, should regulation have in policing CRS market power.

In that regard, American has said before, and still believes today, that the Internet and new technologies, rather than continued or enhanced regulation, offer the best hope for ending CRS market power. However, the CRSs also understand the evolving threat to their market power and are urgently trying to avoid disintermediation by less expensive distribution channels. Some have concluded that the best strategy is one that leverages their existing market power through parity clauses in participating carrier agreements and incentive payments in subscriber agreements to forestall competitive challenges. Preventing this abuse of CRS market power should be the Department's most important policy objective.

Sabre's efforts to obtain American's web fares through parity clauses in its Participating Carrier Agreement ("PCA") illustrate this danger vividly. In 1997, Sabre argued in this rulemaking that CRSs should have to "compete" for access to web fares, and, as noted in the NPRM, Sabre further represented that it had no intention of suing an airline under the PCA for access to web fares. Unfortunately, despite its words, Sabre has never really shown any interest in competing for web fares. After negotiations with American failed to produce an agreement on web fare access, Sabre contracted with FareChase, a company with an Internet scraping product. Sabre asked FareChase to customize its product so that Sabre subscribers could scrape AA.com and other airline sites for

web fares. Finally, after American sought to enjoin FareChase from scraping AA.com, Sabre filed a claim against American alleging that the PCA obligated American to give all Sabre subscribers access to American's web fares.

The Department's NPRM was percipient in specifically calling for comments on access to web fare and the abuse of CRS parity clauses. The unrestrained enforcement of parity clauses would undo much of the progress that has been made in developing alternative distribution channels and would recreate and expand the mandatory participation obligations that the Department has wisely proposed to eliminate in the NPRM. Parity clauses are, quite simply, a lever the CRSs hope to use to avoid competing for access to fares and other content.

The Department's NPRM also comes at a time when its decision not to precipitously regulate the Internet or Orbitz has been vindicated. Although Orbitz dominated the comments in 2000, American's EveryFare® program and its agreement with Travelocity have eviscerated any argument that Orbitz had a monopoly on web fares or would eliminate its competitors. Orbitz remains third in the online travel agency market, Expedia has become the world's largest online agency – despite not having access to American's web fares, and traditional brick and mortar agencies still account for a majority of American's bookings.

Orbitz was never an attempt by its owners to monopolize airline distribution – an impossible objective fabricated by those who saw Orbitz as competition – but was instead an effort to create a new business and to stimulate

cost competition in airline distribution. Largely in response to Orbitz, some CRSs have offered to discount booking fees -- something they had never done before -- in return for the right to distribute web fares.² Because CRSs still control the majority of bookings, the discounts have not been competitive,³ and the demanded consideration -- essentially requiring the airlines to treat the CRS on the same terms as low cost distributors -- has been too high for most carriers. In this regard, these proffered terms reflect continued CRS market power.

However, over time, slowly building market forces could lead to competitive, cost-based CRS pricing. Preserving that modest and still vulnerable momentum towards lower booking fees should be among the Department's foremost objectives. American fully supports the Department's approach of seeking "ways to enable market forces to work more effectively in the CRS business, to avoid potentially burdensome regulations, and to allow airline distribution practices to develop in ways that may eliminate the need for the rules." *NPRM* at 69368.

Thus, subject to some limited exceptions, such as regulations addressing parity clauses, fewer regulations and a greater reliance on market forces is the shortest path to a competitive CRS market. American encourages the Department to abide by its stated preference for relying on market forces and

² The Department's Inspector General has directly attributed the 10% discounts now offered by two of the GDS as a response to Orbitz. OIG Comments On DOT Study of Air Transportation Services, Number CC-2002-061 (December 10, 2002).

³ Sabre's offer to discount booking fees by 10% in return for web fares is a mere fraction of the cost savings that airlines obtain through Orbitz, EveryFare® agencies, and other low cost distributors. Sabre is simply hoping that 10% is all the price it will need to pay for temporarily forestalling the growth of more competitive distribution channels, and most airlines, including American, are demanding more.

insisting on clear and substantial evidence before regulating. The circumstances that the Department must address today are much different from those it considered in 1992, when it imposed mandatory participation and re-imposed the ban on discriminatory pricing. These regulations have limited airline options and have allowed CRSs to avoid competing for access to fares and inventory. American concurs with the NPRM's findings that the mandatory participation rule and non-discrimination rule now do more harm than good.⁴

The proposed regulation of MIDT content is a regrettable exception to an otherwise well thought out NPRM that attempts to deliver on the Department's long-stated preference for market forces over regulation. The CRS regulations are not an appropriate platform for seeking to regulate competition between airlines. Yet in the guise of regulating MIDT, the Department is seeking to do exactly that. This proposed regulation does nothing to inhibit CRS market power, but instead, and without any fact based justification, would tip the competitive balance between large and small carriers and interfere with thousands of contracts. The Federal government stopped regulating how airlines compete long ago, and the result has been the largest, most price competitive airline industry in the world. In proposing to restrict MIDT, the Department would depart from its regulatory mandate, ignore its own regulatory standards, degrade the quality of information in the market, and penalize those carriers that have made

⁴ Some commenters to the docket have benefited from the unintended consequences of the CRS regulations and are encouraging the Department to regulate even more. These calls for greater regulation have lost sight of the purpose of the CRS regulations, which were implemented to protect airlines from CRS market power – not to guarantee CRSs and travel agents access to airline fares and inventory, regardless of costs.

investments in systems that use universally available information. Ironically, the Department has done so at time when the CRSs and other vendors are developing products to make it even easier for smaller carriers to utilize this data.

This intrusive regulation could not have come at a worse time. Airlines are losing billions of dollars and are urgently seeking to identify the right size for their networks, a profitable combination of routes, and the most effective marketing strategies. The Department's proposal to intentionally degrade the quality of information in the marketplace would result in poorer decision making and greater losses. The inefficiencies and unintended consequences of the Department's proposed rule on MIDT are both obvious and significant.

II. The State of the Airline Distribution and the Persistence of CRS Market Power

CRS market power was created over the course of many years, and it is not going to disappear in just a few years. The fundamentals of CRS market power remain intact, including: (1) the continued disconnection between the purchasing decision (made by the travel agency) and the payment obligation (incurred by the airlines); (2) undiminished CRS pricing power; (3) the large percentage of industry bookings made by traditional travel agencies using a CRS; and (4) the continued lack of substitutability between CRSs.

The Structure of the CRS Market: The ability of every CRS to impose price increase after price increase, even in the most dire financial environment, is a product of an unaligned CRS market that was designed to preserve CRS pricing power. The CRS industry has never had a low cost provider – such as

the airline industry has in Southwest – because CRSs have never had to compete for participating carriers. As the Department of Justice has explained:

The ability of CRSs to exercise market power with respect to booking fees stems from the asymmetry in the market for CRS services: carriers pay the entire booking fee, but travel agents and consumers ultimately determine which CRSs are used. . . . Since the booking fee is paid by the carrier, however, there is no reason for the agent or the consumer to concern itself with the level of the booking fee. Thus, the carrier must pay the fee if it wants the booking, and it has no opportunity to bargain with the CRS over price or substitute another CRS charging a lower fee.

Comments of the Department of Justice, p. 44, DOT Dkt. 46494 (July 9, 1991) (“DOJ 1991 Comments”).

DOJ’s 1991 comments identified a flawed and uncompetitive CRS market, and the intervening twelve years have only exaggerated its inherent costs and inefficiencies. Travel agents are no longer merely indifferent to the price paid by the airline; CRS productivity payments have given them an incentive to select the highest cost CRS.⁵ In this perverse market structure, a reduction in booking fees does not generate incremental sales for a CRS, but only diminishes the revenues available for purchasing the patronage of travel agents in a high cost distribution network.⁶ Thus, CRSs actually view offering a lower booking fee as a competitive disadvantage. A more dysfunctional market is hard to imagine.

⁵ One law firm soliciting to represent large travel agencies in this rulemaking has described this sharing of excess CRS profits as “the most reliable revenue stream that most large agencies have.” (attached as Exhibit 2) This solicitation fails to recognize that these payments do not reflect a value-added payment earned by the agency, but simply a payment that maintains CRS market power. There is no question that travel agencies that create value (and many do) will be compensated in the market place by consumers, and in some instances by commission agreements with individual airlines.

⁶ Affidavit of Gary J. Dorman (Attached as Exhibit 3) (Hereafter, Dorman Affidavit at ____).

Sabre, for example, raised its 2003 booking fees over three percent, after claiming that Amadeus has raised its rates by approximately six percent. Sabre implemented this increase despite its own projections that booking would decline two to three percent. In explaining this price increase in the face of the worst financial environment in the history of aviation, Sabre cited a projected rate of growth in incentive payments to travel agencies in the high teens⁷ – five to six times the rate of growth of the CPI. In the FareChase litigation, one Sabre executive testified that incentive payments have been growing at an alarming 30% annually.⁸ When questioned by analysts about the relationship between increases in booking fees (paid by the airlines) and increases in incentive payments (paid to the travel agencies), Sabre described them as “like numbers.”⁹ These spiraling travel agency incentives, made to protect CRS market power, is clear evidence that CRS pricing is not cost based or subject to prevailing economic conditions or normal market forces.

Sabre is not alone in aggressively purchasing travel agency loyalty to high cost CRSs. Incentive payments paid by the CRSs account for \$1.00 to \$1.50 (25 to 35 percent) of booking fees.¹⁰ Most recently, on February 25, 2003, Amadeus launched a new pricing plan for North American agents that purports to eliminate

⁷ “Event Brief of Sabre Holdings 2003 Financial Outlook Analyst Conference Call”, Fair Disclosure Wire, December 16, 2002. (Attached as Exhibit 4).

⁸ Relevant portions of testimony in the FareChase litigation are attached as Exhibit 5. (Hereafter, FareChase testimony at ____). Testimony concerning the growth in incentive payment is found on page 8.

⁹ “Event Brief of Sabre Holdings 2003 Financial Outlook Analyst Conference Call”, Fair Disclosure Wire, December 16, 2002. (Attached as Exhibit 4).

¹⁰ “Sabre Unveils Price Hike for 03”, Business Travel News Online, December 13, 2002. (Attached as Exhibit 6).

productivity pricing for travel agencies that forego a signing bonus in their CRS contract.¹¹ Yet, this new program, not surprisingly, maintains the unaligned CRS market by paying agencies that sign contracts under the ProfitChoice program a rebate per booked segment.¹²

Amadeus claims that under ProfitChoice a travel agency that produces 55,000 segments annually would receive \$76,500 (about \$1.40 per booking). Under the old productivity pricing, Amadeus says the same agency would have received \$30,600 a year. ProfitChoice is not in any sense a reform of productivity based agreements, but is instead only an acceleration of costs that will, inevitably, lead to higher booking fees. One prominent travel agency advocate has appropriately observed that "[a]ll four [GDS] vendors are getting easier when it comes to quotas and more generous when it comes to bonuses...."¹³

These increasingly large incentive payments may be pure profit to the agents, but their true nature is that of monopoly rents being extracted by the CRSs from carriers, and then distributed, in part, to travel agents in order to protect the CRSs' entrenched position. The disconnection between the payment obligation and the purchasing decision, as influenced by ever increasing productivity payments, creates a constant upward pressure on CRS prices, even as the cost of providing the service declines.

¹¹ "Amadeus Plan Offers Contract Options", Travel Weekly Online, February 23, 2003. (Attached as Exhibit 7).

¹² Id.

¹³ Id.

The NPRM acknowledges these facts when it states, “every system seems to continue to engage in subscriber contract practices that keep airlines and travel agencies from using alternatives to the systems and thereby entrench each system’s market power. The likely result is higher airline costs and thus higher fares for consumers.” *NPRM* at 69383. The fact is no reasonable airline, acting in a competitive environment, would buy into a CRS market that provides incentives to travel agents and CRSs to collectively raise the airlines’ distribution costs. It is a model that persists because market power persists, and, as shown below, has led to continually rising CRS prices.

Pricing Power: As the Department stated in 1992, “the best evidence [of market power] is a vendor’s ability to set prices for its CRS services without regard to costs, because vendors need not compete for participating carriers.” Final Rule 57 Fed. Reg. 43780, 43789 (Sept. 22, 1992) (“*1992 Final Rule*”). Based on this and other evidence, the Department concluded, “booking fees charged by the major vendors have been found to be substantially above their costs.” *Id.* at 43831. Since 1992, the situation has only deteriorated. Booking fees per segment have increased 70%, despite reductions in computing and telecommunication costs, and despite dramatic reductions in the average fare collected by the airlines.¹⁴

As shown in the chart below, since 1995, CRS fees have increased at over two times the rate of the Consumer Price Index.

¹⁴ Testimony of DOT Inspector General Kenneth Mead before the Senate Committee on Commerce, Science, and Transportation, p. 16 (July 20, 2000) (Attached to American’s September 22, 2000 Comments).

Increases in CRS Booking Fees Experienced by American Airlines (CRS fees per net booking)	
	Compound Annual Growth Rate <u>1995-2002</u>
Amadeus*	6.3%
Galileo	6.5%
Sabre	5.2%
Worldspan	5.3%
Consumer Price Index	2.4%

Sources: booking fee data provided by American Airlines; CPI data from the U.S. Department of Labor, Bureau of Labor Statistics.

* Amadeus includes System One in years 1995 through 1998.

The current state of the airline industry has made the CRSs' extraordinary pricing power even more of a concern. The U.S. airline industry is facing an economic crisis unlike any ever experienced before. While the unprecedented declines in demand for air travel is a primary cause, that decline is magnified by the industry's notoriously high costs. Survival in the industry now depends on reducing these costs, and the industry has responded with massive and painful self-help measures to reduce losses and stabilize the business. According to the Air Transport Association:

These measures have seen 100,000 job cuts, schedules modified, thousands of flights eliminated, office and facilities closed, several hundred aircraft retired or placed in storage, more than \$10 billion in reduced capital and operating budgets – and the cutting goes on. Negotiations are underway to reduce employment expenses throughout the industry by an additional \$10 billion.¹⁵

¹⁵ "Airlines In Crisis: The Perfect Economic Storm", Air Transport Assn. Report (Attached as Exhibit 8).

In 2001 and 2002, the airline industry in the United States lost an estimated \$12 billion, and is projected to lose another \$6.7 billion in 2003 (absent a war with Iraq).¹⁶ During these last two years, traffic has fallen 8.2%, and fares have fallen 15.4%.¹⁷ At the same time, post 9/11 taxes, fees, and unfunded mandates have added more than \$4 billion to the industry's annual cost burden.¹⁸ Two major carriers are currently operating in bankruptcy and others are threatened.

CRSs derive the overwhelming majority of their revenue from airline booking fees. In a competitive market, CRSs would be under enormous pressure to reduce, rather than increase, prices. Indeed, other major suppliers to the airline industry, such as aircraft manufacturers, aircraft lessors, food and beverage suppliers, and even labor unions are making concessions. Yet, earlier this year all of the CRSs did as they always have and increased booking fees for 2003. Even in these extraordinary times, CRSs remain immune to pricing pressures.¹⁹

Booking Volumes:. American has made some progress in shifting a percentage of reservations to lower cost distribution channels, such as direct connect, Orbitz, and Travelocity, but the fact remains that American, like other network carriers, continues to rely on travel agents using a CRS for the majority of its ticket sales. Travel agents that do not participate in the EveryFare® program thus represent American's highest cost distribution channel, and by a

¹⁶ Id. at 23.

¹⁷ Id.

¹⁸ Id. at 16.

significant margin. In 2002, for example, American's cost of sale for "brick and mortar" travel agencies in the U.S. was two and one half times its cost of sale through Orbitz, and that was before American implemented its direct connection with Orbitz. Yet, at the same time, brick and mortar agencies using high cost CRSs made sixty percent of American's U.S. sales.

Even if one were to take into account that American's average fare from "brick and mortar" agencies exceeds the average fare from lower cost distribution channels, CRSs are still more expensive than low cost distribution channels. In 2002, American's cost of sale per \$1,000 in revenue through other channels was significantly lower than for "brick and mortar" agencies using a CRS. Thus, the Department should not be fooled by CRS claims that their higher costs somehow represent a better value because travel agency sales generate more revenue per ticket sold.

Lack of Substitutes: For the foreseeable future, most major airlines will be compelled by the economic realities of the market to participate to some degree in every CRS.²⁰ The Department is correct to "still believe that high booking fees are probably imposing burdensome costs that most airlines have not been able to avoid and are likely to increase fares paid by consumers." *NPRM* at 69422.

The CRSs have significant market power vis-à-vis the airlines because the four CRSs are not substitutes for each other. While some travel agency locations use more than one CRS, the travel agency subscriber lists for the four

²⁰ As long ago as 1983, the DOJ observed that "no nationwide carrier can afford to forego listings on any major CRS, and therefore, rivalry among the CRSs cannot be expected to serve

CRSs are sufficiently distinct that an airline's participation in any one of the four cannot substitute for its participation in any of the remaining three.²¹ Withdrawal from one CRS, even if the CRS rules were modified to allow it, would likely cost an airline more in lost ticket revenues than any savings it might achieve on booking fees. Even if an airline somehow could recapture lost bookings through another CRS, its total booking fees would not decline because all four CRS vendors charge similar prices.

Some limited substitution possibilities exist for some part of CRS distribution, such as direct reservations, airline websites, and certain third-party websites. These alternatives, however, are far from perfect since they require substitution for the entire travel agent/CRS distribution channel, not just for CRSs. For American and many other major carriers, it is not a solution to cease using travel agents to distribute its products. American relies heavily on travel agents because it sells a network of services that is vastly more complex than the services offered by point-to-point carriers such as Southwest and JetBlue. The breadth, and resulting complexity, of American's system is enhanced by its participation in oneworld[®], and by codeshares with over 15 carriers to dozens of destinations around the world, and interlines with over 240 carriers. Although some consumers are comfortable making their own travel arrangements for simple short-haul leisure travel, others prefer to use and pay for travel agents. Large corporations, for example, have complex air travel needs and find it more

as a check against the exercise of market power by any one of them." Comments and Proposed Rules of the Department of Justice, DOT Dkt. 41686, p. 46 (Nov. 17, 1983).

²¹ Dorman Affidavit at 5, 8.

efficient to use a travel professional. American operates a large network, and enters into various alliances, in order to be attractive to these types of business customers who demand (and are willing to pay for) professional management of their travel. For these reasons, American and other network carriers will remain subject to CRS market power as long as travel agents remain tied to high cost CRSs.²²

The Department is plainly correct that, “[t]he Internet’s growing importance in airline distribution does not seem to have significantly eroded each system’s market power thus far.” *NPRM* at 69420. And, in fact, recent economic studies have found that CRS market power over traditional carriers has remained durable and pervasive.²³

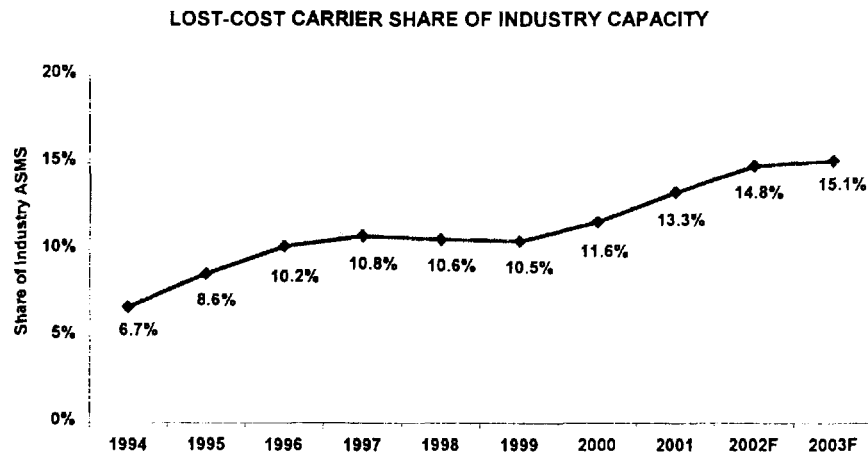
III. Supracompetitive Booking Fees Distort Airline Competition

It is axiomatic that a large, growing, and uncontrollable expense, as CRSs fees are, threatens, and will continue to threaten, airline competition, particularly in the industry’s current state of duress. American is under tremendous pressure to stem massive losses and can ill afford inflated costs that adversely affects both the overall demand for its airline services and its competitiveness with rivals that enjoy lower costs because they are less reliant on CRSs and thus less victimized by supracompetitive CRS pricing.

²² Dorman Affidavit at 7.

²³ “Economic and Political Analysis of Computer Reservation Systems, OXERA Consulting Ltd. (2001), pg. iii (CRSs have significant market power over airlines because each controls a large proportion of travel agents in the downstream market. From the airlines’ perspective, CRSs are not readily substitutable for one another, as each CRS controls access to an important share of passengers through its member travel agents) (attached as Exhibit 9)

As shown by the following chart, during the last eight years, low-cost carriers' share of total industry capacity has grown from 6.7% to 13.3%, and is forecasted to exceed 15% by the end of this year.



This growth has led to more competition between low-cost carriers and traditional carriers such as American. Today, American faces direct competition from low-cost carriers on about 80% of its origin & destination markets, and it can expect this percentage to increase.

One major difference between American and carriers such as Southwest and Jet Blue is how it distributes tickets. Today, online and brick and mortar travel agents using CRSs still sell nearly 70 percent of American's tickets. Southwest and Jet Blue, however, largely avoid travel agents, and with them, associated CRS booking fees. Southwest recently announced that more than 80 percent of its bookings in the last quarter were made directly via the Internet on its own website or directly with its own reservations agents. Of the four major CRSs, Southwest participates only in Sabre, and at a lower level of functionality

than all other carriers. Thus, substantially less than 20 percent of Southwest's total bookings are made through travel agents using a CRS, while 70 percent of American's bookings incur CRS booking fees.

The differences between American and JetBlue are even more striking. According to its filings with the Securities and Exchange Commission, JetBlue booked 92.6 percent of its sales either through its Internet site (44.1 percent of total bookings) or its own telephone reservations personnel (48.5 percent of total bookings).²⁴

This dichotomy in CRS market power between large network carriers and no-frills point-to-point carriers, like Southwest, is even evident in Sabre's strategy of obtaining web fares. Sabre is willing to aggressively attempt to disrupt American's distribution initiatives through screen scraping and litigation, but it has made a "business" decision not to pursue a similar strategy against Southwest, another Sabre participating carrier.²⁵ Sabre is plainly concerned that it does not have the same market power against Southwest, as it does against American.

The significant differences in the cost of distribution were in large part created by the current CRS rules, which have reinforced CRS market power over network airlines by shielding the CRSs from normal market forces. At the same time, low cost carriers, such as Southwest, are not subject to CRS market power because they have always pursued a "no CRS, no travel agent" model of

²⁴ JetBlue Airways Corporation, S.E.C. Form S-1 Registration Statement, p. 38 (Feb. 12, 2002) (Attached as Exhibit 10)

distribution. Thus, the CRS rules have had the perverse effect of reducing the cost competitiveness of major network carriers versus their low cost rivals.

IV. Regulatory Reform Is Needed to Stimulate Competition In the CRS Market

Airlines have made inroads into CRS market power, but as discussed, a competitive CRS market does not yet exist. Moreover, the progress that has been made remains at risk. No CRS has a low cost strategy nor, as evidenced by Sabre's statements and Amadeus's ProfitChoice, is any CRS abandoning a business model that inflates distribution costs. Sabre's strategy of milking the "cash cow" for as long as possible is being implemented across the CRS industry, and this rulemaking -- including how quickly it is adopted -- will greatly affect how much "milk" is yet to be obtained from the CRS "cash cows."

A. The Zero Fee Or Some Other Fee Shifting Proposal Remains the Most Effective Response To CRS Market Power

The "zero fee" proposal originally recommended by the Department of Justice in 1991 and discussed in American's October 23, 2000 comments remains the quickest and most effective way to create a competitive CRS market. DOJ explained its rationale as follows:

the zero booking fee rule correctly aligns the travel agents' ability to choose among systems with the travel agencies' incentive to do so since the CRS charges will directly affect the travel agents' profits. Thus under the zero booking fee rule competition among vendors to obtain travel agent contracts will determine the level of booking fees paid by travel agents.

DOJ 1991 Comments, p. 18. In the same rulemaking, the Department agreed that, "the vendors' decision to obtain more compensation from participating

²⁵ FareChase testimony at 118 to 120.

airlines than from travel agencies presumably reflects the difference between the vendors' competition for airline participants and their competition for subscribers" *1992 Final Rule* at 43783.

No one disputes that CRSs compete for subscribers. Re-aligning the CRS payment obligation with the purchasing decision in this competitive environment would end supracompetitive CRS prices instantly. The CRSs' response to American's EveryFare® program illustrates the threat that a properly aligned market poses to CRS market power. EveryFare® is based on the same principle as DOJ's proposal -- it is the travel agent that is best positioned to obtain a competitive price from the CRSs. Under EveryFare®, American provides travel agents with access to web fares in exchange for the travel agents taking partial responsibility for CRS booking fees. The goal of the program is to induce competition among CRSs on price (including booking fees) and the quality of the service. Consumers also benefit. One of American's launch partners for EveryFare®, TQ3 Travel Solutions, reports that its participation has saved an average of 7 percent "compared to corresponding GDS published rates" for seven clients with varying usage.²⁶

Of course, EveryFare® cannot unilaterally reduce CRS fees, and the CRSs are not being asked to make any contribution to the cost savings. In a properly aligned and competitive market, CRSs would be indifferent as to whether airlines and travel agencies agree to split CRS booking fees. Yet, Sabre

²⁶ "AA's EveryFare Save TQ3 Clients 7 Percent On Average", Business Travel News Online, (March 12, 2003) (Attached as Exhibit 11).

is far from indifferent, and one its senior executives has candidly acknowledged that Sabre would like to see EveryFare® fail.²⁷ CRSs are aggressively marketing against EveryFare® and have intensified their efforts to obtain access to web fares through screen scraping, and, in Sabre's case, litigation. The CRSs know that their profits cannot be sustained in a competitive market where the purchasing decision and the payment obligation are aligned.

EveryFare®, however, cannot be a complete solution to CRS market power. Through large, and ever increasing, productivity payments, CRSs have co-opted travel agencies into a business model that preserves CRS market power and demands supracompetitive fees. EveryFare® rewards subscribers for finding the lowest cost CRSs, but any such CRS, if it even existed, would have less revenue to kick back to subscribers as incentive payments. Many agencies are reluctant to forego these large payments from CRSs, particularly in light of misrepresentations from the CRSs that they can scrape for web fares or that the PCA compels the airlines to provide universal access to the lowest fares.

The zero fee proposal overcomes this problem by giving both types of CRS users -- the airlines and the travel agents -- the same interest in lower booking fees. As long as the CRS market retains its current payment structure, neither EveryFare®, nor any other airline initiative, can bring full market forces to CRS pricing.

²⁷ FareChase testimony at 140.

The NPRM acknowledges that the zero fee proposal reflects sound economic theory and would lead to a competitive CRS market.²⁸ *NPRM* at 69399. It rejects the zero fee proposal, however, based on a concern that any such regulation would be “too disruptive.” *Id.* Any disruption, however, could be minimized by transferring financial responsibility to subscribers over time and in phases. As a starting point, subscribers would only be responsible for CRS rate increases, which would, at least, halt the unrelenting increases in CRS prices. The regulation could phase in greater financial responsibility so that within three years subscribers would share 50% of the financial responsibility for booking fees. This phased approach would give subscribers an opportunity to shop for the lowest cost CRS before being partially responsible for CRS costs, and it would allow CRSs time to adjust to a more competitive environment. Since subscribers would now have a financial interest in CRS costs, one or more CRSs would have an incentive to adopt a low cost strategy. This sharing of financial responsibility would also address the Department’s other stated concern with

²⁸ As described by the Department:

Such a “zero fee” rule would effectively require the [CRS] systems to obtain their revenues from fees paid by travel agencies. As shown, the systems compete for travel agency subscribers but have not competed for airline participants, since most airlines have been compelled by their marketing needs to participate in each system, even if the terms of participation are unattractive and non-negotiable. Because travel agencies can choose between the systems, the systems would compete on price. A zero fee rule thus would cause the price of CRS services to be set by competitive market forces.

Notice of Proposed Rulemaking, pp. 150-51, Dkt Nos. OST-97-2881, OST-984775, and OST-99-5888, November 15, 2002.

regard to the zero fee proposal. Airlines would not be getting CRS services for free.

B. The Department Should Finalize Many of
The NPRM's Proposed Changes

The NPRM contains three important reforms that together have the potential to introduce market forces into CRS pricing: (1) ending mandatory participation; (2) allowing CRS price discrimination; and (3) prohibiting CRS productivity payments to subscribers. The NPRM also invites comments on a rule that would prohibit CRSs from enforcing parity clauses to gain access to fares and inventory. Sabre's recent actions, in this regard, have greatly heightened the need for a revised and expanded ban on parity clauses.

Action on all four of these points would ignite new market forces and may finally give rise to negotiated CRS contracts and pricing. For these regulatory reforms to succeed, however, action must be taken on all four, as a failure to act on one will diminish the effectiveness of the others.

1. The Department Should Prohibit the Enforcement of Parity Clauses

The NPRM was prescient in recognizing the dangers that the unrestrained enforcement of parity clauses poses for competitive airline distribution costs. Parity clauses have the potential to become the last bastion of CRS market power, and Sabre's claim against American in the FareChase litigation highlights the far-reaching implications.²⁹ From this litigation, American has learned that:

²⁹ Sabre's complaint against American is attached as Exhibit 12.

Sabre will try to use parity clauses to gain access to web fares, despite its prior representation to the Department that it would not do so.

Sabre broadly interprets the term "CRS" in its contract so that fares distributed through an airline web site or an online agency, like Orbitz, are swept up by this alleged "parity" obligation.³⁰

Sabre would prefer that web fares "go away" since they are the airlines' most potent tool for moving reservations to lower cost distribution channels.³¹

Sabre, in particular, has long sought to gain access to web fares through political and regulatory channels, and thereby eliminate these fares as a mechanism for fertilizing the growth of lower cost channels. However, until the launch of EveryFare®, Sabre had not sought to enforce through the legal process a contractual right to web fares.³² Sabre has now asked a Court to read the parity clauses in the PCA in a way that would impose an unprecedented obligation on American to make web fares available to every Sabre subscriber. Sabre has also sued Air Canada under the same theory.³³ If Sabre's claims in

³⁰ FareChase testimony at 210-211.

³¹ FareChase testimony at 67.

³² Sabre's claims under the Participating Carrier Agreement are at odds with its own conduct over the past several years. As the Department knows, no entity worked harder for regulations that would have required Orbitz owners to provide universal access to web fares. Sabre also devoted considerable time and resources to co-developing a scraping product with FareChase. All of this begs a question, why all this effort if the Sabre Participating Carrier Agreement already gave it access to participating airlines' web fares?

³³ Sabre's complaint against Air Canada is attached as Exhibit 13.

either case should somehow succeed, it and other CRSs can be expected to pursue other airlines as well.

The NPRM takes explicit notice of the parity clauses cited by Sabre in support of its alleged right to widely distribute American's web fares, and correctly describes the anticompetitive implications of Sabre's interpretation:

[A] participating airline should have some ability if practicable to persuade travel agencies to use a system or similar electronic service that provides better service or charges lower fees. Insofar as Sabre's contract would bar this, it would keep an airline from taking steps to reduce its CRS expenses. It would also be directly contrary to our conclusion in the parity clause rulemaking that airlines should normally be free to choose the quantity and quality of service bought from their suppliers.

NPRM at 69393 (emphasis added).³⁴

The unrestrained enforcement of parity clauses would, indeed, undo much of the potential in developing alternative distribution channels, and would simply reincarnate and expand the mandatory participation obligations that the Department has proposed to eliminate in the NPRM. If Sabre is correctly interpreting its PCA, the implications for airlines, low cost distributors,

³⁴ In 1997, the DOT asked for comments on whether CRS regulations should extend to the Internet, including whether web fares should be distributed through CRSs. Sabre responded that:

"[it] strongly believes that CRSs should be permitted and encouraged to compete with each other to have access to distribute these fares. As demand for wider distribution of fares increases, CRSs will respond to these market pressures with products and features that make it worthwhile for carriers to make the fares more widely available."

In Re Advance Notice of Proposed Rulemaking, Computer Reservation System Regulations, Notice No. 97-9, Reply Comments of the Sabre Group, Dkt No. OST-97-2881 at 10 (Feb. 4, 1998) (emphasis added).

consumers, and the Department's regulatory initiatives are profound. Airlines would lose their most effective tool for creating and encouraging the growth of lower cost distribution channels. Initiatives like EveryFare® would be fatally wounded. Travelocity and other distributors would have no reason to be competitive with low cost channels. Airlines could not even provide special fares to direct consumers to their own web sites. CRSs, which are two to three times as expensive, would be given equally robust access to fares and inventory. Much, if not all, of the progress that has been made in the past few years would be lost, and CRS market power will have fended off its only real challenge in many years.

The consequences for consumers are equally clear. CRS charges would remain an uncontrollable and excessive cost for all of the major airlines (with the exception of Southwest) resulting, inevitably, in higher fares. Web fares, which are among the most highly discounted fares, would likely disappear since these fares could no longer serve their primary purpose of directing consumers and agents to lower cost distribution channels. Indeed, as mentioned, Sabre's witnesses have candidly acknowledged that they would prefer that web fares disappear.

The Department thus correctly describes the enforcement of PCAs as a potentially unreasonable restriction on how airlines distribute their services and an impediment to "keep airlines from pursuing the most efficient and least costly distribution channels." *NPRM* at 69393. The policy issue, as recognized by the

Department, is whether airlines are free to develop more cost effective ways to distribute their product or whether CRSs can defeat these efforts by leveraging their market power:

If Sabre's contracts are typical, the systems may be imposing contract terms on airlines that unreasonably restrict airline choices on how to distribute their services. Such contract clauses could keep an airline from pursuing the most efficient and least costly distribution channels. Airlines should be free to choose to offer E-fares only through their own websites, without being obligated by system contracts to make them available through other distribution channels. This kind of contract clause would frustrate our efforts to allow airlines to create ways of bypassing the systems when doing so is more cost effective and likely to establish competitive discipline for the systems' prices and terms for participation.

NPRM at 69393. Sabre's willingness to sue American and Air Canada for access to web fares, in the face of the Department's articulated concerns, shows that regulation is urgently needed to restrain the anticompetitive enforcement of parity clauses.

For these reasons, the Department should readopt its ban on the enforcement of parity clauses and expand the language of the regulation to encompass any claim that parity clauses compel access to airline fares or inventory.

The Department should also eliminate the exception for airlines that own or market a CRS. As the *NPRM* acknowledges, abolishing the mandatory participation rule would accomplish nothing if the same obligations are simply imposed against airlines that market a CRS through a PCA that is not negotiated. As shown below in the discussion concerning the mandatory participation rule, the incentives for an airline to use its position in the market place to favor a CRS

have vanished. In this regard it warrants notice that the current “parity clause” litigation involves American in a lawsuit against Sabre – the CRS that it markets.

2. The Department Should Eliminate the Mandatory Participation Rule As Proposed in the NPRM

When the Department adopted the mandatory participation rule in 1992, it confronted a rapidly growing CRS industry that was controlled by airline owners. Under these circumstances, the Department was concerned that airline owners would willingly sacrifice ticket sales in competing systems in order to move CRS market share to their owned or jointly owned CRS. *1992 Final Rule* at 43800. The Department also assumed that airlines benefited from a “halo” effect, and therefore had an additional reason to move CRS market share.

Irrespective of whether these were reasonable assumptions in 1992, they do not reflect the realities of the CRS market today. The debate over the mandatory participation rule is quickly becoming moot. Worldspan, the last of the four domestic CRSs owned by U.S. airlines, announced earlier this month that it is being sold to non-airline owners. Thus, the only CRS that retains any airline ownership is Amadeus, and all of its airline owners are European.

The mandatory participation rule addressed competitive concerns in a much differently structured market. Airlines have been exiting the CRS business for years, and no evidence suggests that they, nonetheless, remain willing to sacrifice airline ticket sales in an attempt to influence CRS market share. As a result, the primary effect of the mandatory participation rule over the past few years has been to enhance CRS market power by limiting airline options.

American, therefore, supports the elimination of the mandatory participation rule as proposed in the NPRM.

Given these circumstances, it would be a tremendous mistake for the Department to reinvigorate the mandatory participation rule by extending it to airlines that market a CRS. Such a regulation would not only reintroduce, but would expand, the unintended consequences of mandatory participation, without any reasonable justification.

Leaping to the conclusion that various CRS marketing agreements create the same incentive to move CRS market share as airlines ownership did ten years ago is both unsupported and dangerous. American's marketing agreement with Sabre does not preclude it from participating at any level in a competing CRS nor does it require American to discriminate against other CRSs in terms of functionality or content. The payments that American receives under the marketing agreement are less than one hundredth of one percent of the revenue that it earns through airline sales, and Sabre's February 2003, 3.3% booking fee increase involves more money than American collects in an entire year under the Sabre marketing agreement. Quite simply, American's interest in maximizing airline sales – particularly at a time when it is losing millions each day -- far, far outweighs any interest it has under the Sabre marketing agreement. Although American is not privy to other marketing agreements, it strongly suspects that other airlines are in the same position.³⁵ United, for example, has been free of the mandatory participation obligation for years, but it has not degraded the

³⁵ Delta, for example, has stated that it spent \$350 million in CRS fees last year.

quality of the information and functionality in any of the CRSs that compete with Galileo.

Airlines that market CRSs include American, United, Delta, Northwest, Southwest, and maybe others. Tying the hands of these carriers through regulation would strengthen CRS market power and do so in the absence of any showing that these marketing agreements are distorting either CRS competition or airline competition.³⁶ The Department's focus should be on reducing, not bolstering, CRS market power. For these reasons, the Department should eliminate mandatory participation in all of its forms as proposed by the NPRM.

3. The Department Should Allow Discriminatory CRS Pricing
As Proposed in the NPRM

The regulatory ban on discriminatory CRS pricing is also a rule that now does more harm than good. It, like the mandatory participation rule, was crafted at a time when airline and CRS ownership were intertwined, and it sought to address incentives created by airline CRS ownership that no longer exist.

In banning discriminatory pricing, the CAB cited allegations that airline owners were using CRS fees to penalize those carriers that competed the most vigorously with the CRS owners. It noted:

The record demonstrates that some vendors currently charge differential prices based on considerations of air transportation competition. . . . Thus, a carrier ownership of CRS's would continue to affect air transportation competition adversely. . . . [T]he unjust discrimination rule . . . is the minimal intervention which should cure the problems of existing pricing practices, i.e. vendor prices to individual carriers that are based on air transportation competition.

³⁶

Dorman Affidavit at 7-9.

49 Fed. Reg. 32540, 32552 (Aug. 15, 1984) At various time, the CAB also has expressed concern that the major carriers, most of which had stakes in a CRS, could take care of themselves, but smaller, unaffiliated airlines would be the most likely to suffer in a discriminatory pricing environment. *Id.*

The last twenty years have resolved these concerns. CRSs have independent ownership and now pursue their own interests, without regard to the interests of their prior owners. Ironically, smaller, new entrant airlines often enjoy a stronger bargaining position than their larger competitors that once owned the CRSs. The traditional large network carriers still distribute approximately 70% of their tickets through travel agencies using a CRS. Given their customer volumes and their nationwide networks, they still have no choice but to participate in every CRS. As shown above, with regard to these carriers, CRS market and pricing power remain largely undiminished.

The smaller, new entrant carriers, like JetBlue, Frontier, ATA, and AirTran, are to varying degrees less reliant on travel agents and CRSs for distribution. For these carriers, not participating in one or more CRSs is a very viable alternative, just as it has been for Southwest for years. In addition, to the extent that consumers perceive these carriers as offering lower prices, their content and participation is even more valuable to the CRSs. For these reasons, many smaller, low cost carriers are uniquely positioned to obtain the best pricing from the CRSs.

This is not mere speculation. Some CRSs have already developed products targeted to low cost carriers, which offer them access to all CRS

subscribers, but with booking fees that are approximately half of those charged to larger carriers. The CRSs specifically designed these products to include requirements, such as one that limits the participant to operating only one aircraft type, that have nothing to do with CRS costs, but, instead, serve to prevent the large traditional network carriers from buying down.

For these reasons, the Department's ban on discriminatory pricing no longer protects smaller carriers from the alleged anticompetitive practices of larger carriers that once owned the CRSs. In today's environment, the requirement of uniform pricing only serves to forestall negotiation on CRS prices and to enhance CRS market power. Price negotiation is a hallmark of any competitive market, and market forces will never take hold in the CRS market as long as regulation precludes dynamic pricing.

Indeed, even in 1984, the CAB acknowledged that its ban on discriminatory pricing was a significant regulatory intrusion into the marketplace, but it concluded that the tie between airline and CRS ownership, coupled with CRS power, justified regulation.³⁷ That balance of interests has long since tipped in the other direction. As with the mandatory participation rule, the ban on discriminatory pricing is a regulation whose justification and time have passed.

4. The Department Should Ban CRS Productivity Based Contracts

By sharing their supracompetitive profits with travel agencies, CRSs have created a business model that protects their market power and inflates airline

³⁷ 49 Fed. Reg. 32540, 32552 (August 15, 1984) ("DOJ argues, however, that our intervention in CRS pricing may produce inefficiencies that outweigh the benefits of such a rule. There is some merit to DOJ's position. We are sensitive to the risks of distortion inherent in government regulation of prices.")

distribution costs. These productivity payments have grown well beyond giving the travel agent CRS services for free; they have converted CRS terminals into cash machines for the travel agent that now generate up to \$1.50 per booking. Productivity payments do not reflect any value added by the agent, but rather are nothing more than payments to co-opt travel agents into a distribution system that is not cost competitive. New distribution channels – even if they offer superior functionality and content – are at a significant disadvantage, unless they can replace this cash flow generated by supracompetitive CRS fees.

As long as productivity payments remain an accepted CRS practice, no CRS will adopt a low cost strategy, and competitive systems will face an artificial, but significant, barrier to entry. At a time when the Internet and new technologies are lowering the technological costs of competing systems, CRS productivity payments are re-inflating the cost to compete in order to shelter the CRSs' entrenched positions. Alaska Airlines, for example, has contended that productivity payments greatly impeded its direct connection initiatives. Even as agents have used alternative distribution channels, such as Orbitz or AA.com, for access to the lowest fares, productivity payments have given them an incentive to create duplicate CRS bookings.

Accordingly, American agrees with the NPRM that these types of payments should be prohibited. The proposed rule, however, is too narrow. It prohibits payments or discounts conditioned on a "minimum share" of the subscriber's total transactions. CRSs can easily avoid the intent of the rule by simply paying the agent for booking volumes rather than shares. Amadeus's

ProfitChoice is just such a program. As long as CRSs can purchase the loyalty of travel agents to high cost CRSs, the Department's proposed rule will be ineffective and CRS market power will endure.³⁸ If a competitive CRS market is ever going to emerge, the Department must ban all incentive payments to agents for using one or more CRSs.

V. American's Position On Display Bias and CRS Tying

A. The Department Should Maintain Its Ban On Display Bias And Address Screen Padding Through Code Sharing

Maintaining the ban on biased screen display is one of the few areas of consensus among the commenters. American agrees with the NPRM's tentative conclusion to retain the ban on display bias. No party has been able to show that the ban on display bias has hurt airline competition or enhanced CRS market power, and as long as CRSs have market power – as they clearly do – they should remain an unbiased source of information.

American also believes that the CRS regulations should address the growing problem of screen padding caused by the growing number of code sharing flights. Screen padding has long been a problem with the display of international flights, and now that United/USAirways and Delta/Continental/Northwest have formed, or are trying to form, major domestic code sharing relationships, the pernicious effects of screen padding must be addressed. The Department should adopt the EU rule that limits a code share flight to no more than two listings.

³⁸ Dorman Affidavit at 3-7.

B. The CRSs Should Be Precluded From Tying Products

A ban on CRS tying of distribution products will enhance competition, give airlines more options, and preclude CRSs from leveraging their market power into new and developing channels. American agrees with the Department's statement that, "an airline should be able to determine how its services should be distributed and which firms should be able to sell its tickets." *NPRM* at 69392.

American, thus, supports a ban on tying Internet distribution to the CRSs' "brick and mortar" travel agency services, and a ban on tying domestic and international distribution, particularly since CRSs often price these products differently.

If such a rule is adopted, an exception should not be made for airlines that own or market an online agency like Orbitz. The evidence does not support such a mandatory participation type exception. No showing has been made, nor could be made, that Orbitz – or any other airline owned Internet site – has market power, as the Department found CRSs did in 1992.³⁹ Thus, the circumstances presented by Orbitz are fundamentally different from those that led the Department to implement mandatory participation in 1992. Nor has there been any showing that the airlines are discriminating against competing online systems. The evidence is overwhelmingly to the contrary. EveryFare® and American's agreement with Travelocity prove that American is seeking to maximize cost effective distribution – not enhance Orbitz's prospects at the expense of its own. Indeed, in today's hyper-competitive environment, it is

reasonable to assume that all airlines are equally motivated to enhance distribution through all cost effective channels.

Moreover, in originally imposing mandatory participation, the Department was concerned with the regional strength of airlines. However, online agencies compete on a national, if not worldwide, basis. There is no showing that any one airline has market power on such a basis. In fact, Expedia has become the world's largest online agency without having access to American's web fares.

In sum, the Department should prohibit these forms of CRS tying, without exceptions.

VI. The Department Should Not Regulate MIDT Content

The Department's proposed new regulation of MIDT content is an improper exercise of the Department's Section 41712 authority. As the Department and the courts have recognized, the Department's Section 41712 authority must be applied in a manner that is consistent with the spirit of the antitrust laws. 65 Fed. Reg. 45551, 45554 (July 24, 2000). Yet the clear effect of the proposed MIDT regulation is to choose one airline business model over another, and thereby shelter adherents to the chosen model from competition by the disfavored model. Nothing could be more antithetical to the antitrust laws.⁴⁰

The objective of the Airline Deregulation Act of 1978 was to remove the Federal government from the business of selecting what business and marketing strategies should be employed by airlines. The evidence cited in NPRM shows

³⁹ Indeed, the DOT Inspector General has specifically found that Orbitz, as the third largest online agency with 24% market share, does not have any market power. OIG Comments On DOT Study of Air Transportation Services, Number CC-2002-061 (December 10, 2002).

nothing more than that some airlines -- which have chosen to pursue a low-cost strategy and, thus, have not invested in marketing practices that utilize MIDT -- would like the Department to competitively disadvantage those airlines that have adopted a different marketing strategy that includes investing in MIDT analysis. Absent some showing of actual harm to *competition*, rather than alleged harm to competitors, the Department has no authority to put its thumb on the regulatory scale so as to advantage one type of competitor over another. As shown below, the record contains no such showing of harm to competition.

MIDT is a valuable source of market information that has been uniformly available to all carriers since 1984. As recognized in the NRPM, many carriers, including American, have invested significant resources in developing systems to process and analyze this data. In the past five to six years alone, American has invested over \$15 million in building systems that utilize this data. American also has entered into thousands of contractual relationships that rely on MIDT data. These investments and contractual relationships were formed in the light of a regulatory history in which the Department had rejected calls to eliminate MIDT and had, quite appropriately, openly questioned its authority to prevent the airlines from using this data. *1992 Final Rule* at 43820. In 1992, the Department stated:

American is only gaining the benefits of its investment in creating a program for analyzing the marketing data provided by Sabre and the other systems. We see no reason for denying American the use of a program that it had the foresight to develop. Any carrier can acquire the same data. . .

⁴⁰ See *Brooke Group, Ltd. V. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) ("It is axiomatic that the antitrust laws were passed for the protection of competition, not competitors").

Id. at 43789.

Yet in the NPRM the Department has, on the thinnest of records, proposed to restrict MIDT, deprive airlines of the investments they have made in information systems, and interfere with potentially thousands of existing contracts. This proposed regulation is grossly unfair and certain to introduce inefficiencies and unintended consequences into the market.⁴¹

A. The Pro-Competitive Uses of MIDT

Economists agree that markets generally perform better with more information. That general observation is particularly pertinent to the airline business. Major airlines operate complex networks where price and capacity decisions on one segment ripple through an entire network, making it especially important that airlines be able to assess and respond to dynamic market conditions. The notion that airline pricing and capacity decisions are based on a segment-by-segment reaction to the short term pricing and capacity decisions of one or a small group of competitors fails to comprehend modern airline network economics. Nonetheless, even if one were to adopt such an inappropriately narrow view of airline competition, the assertion that MIDT has allowed the major airlines to suppress competition is not supported by any facts.

Airlines use MIDT for two primary purposes: (1) route planning, and (2) administering contracts, such as override contracts with distributors that have above average performance and corporate discount agreements. In both

⁴¹ Dorman Affidavit at 11-15.

instances, far from suppressing competition, MIDT data serves to strengthen competitive forces.

Even in good times, airlines operate in a highly competitive environment and achieve, at best, thin profit margins. Each day, American and American Eagle deploy over 1100 aircraft, on 4100 flights, from over 200 cities. Determining which city-pairs to operate, at what times, with what equipment, and with what frequencies, is an inordinately complex interrelated process, and these decisions have great financial and competitive consequences for the airline and for the communities it serves. To cite just one example, American's recent resizing and rescheduling of its fleet is expected to reduce costs by \$1 billion annually. In undertaking this procompetitive initiative, American knew that a schedule that did not reasonably match demand could cost it hundreds of millions of dollars and significantly diminish its long term competitive position. MIDT was a critical tool in this effort.

American is not alone in using MIDT to deploy its assets more efficiently. From the onset of CRS regulation, the Department recognized that MIDT improved decision-making, and its rules ensured that all airlines had access to this data. By mandating that CRSs make MIDT widely available, the Department enhanced the quality of available information, and the result has been more competitive markets.

There are numerous examples of airlines using MIDT to identify new markets, expand existing markets, and launch competitive initiatives. In the late 1990s, American expanded service on the West Coast, largely in competition

with United and Southwest. American and United are constantly competing to develop a route system that is more attractive to the business community. Late last year, Delta reshaped and rescheduled its Dallas/Fort Worth hub where it competes against American. In every instance, and regardless of carrier identity, MIDT improved the carrier's decision making and in the process intensified competition.

These, of course, are not good times for the industry, and it has never been more important for airlines, like American, to find the right size for their network, the best combinations of city-pairs and frequencies, and the most effective marketing techniques. Accurate and timely data on demand is especially important in this industry because airlines supply a perishable product that cannot be inventoried. Potential revenue from empty seats is lost forever once a flight departs. Yet, the Department is now proposing to degrade the quality of available information, which will inevitably lead to poorer decisions, even greater losses, and in the long run less competition.⁴²

MIDT also offers the most efficient means for monitoring performance under travel agent override agreements and corporate discounts. Very few issues have been as thoroughly studied and scrutinized by the Department (and other government agencies) as have override agreements, and yet in the wake of all the inquiry, the Department has never found justification for regulation. This lack of regulatory action is not surprising since agreements that reward

⁴² As explained below, providing carriers access to their own information, as proposed in the NPRM, is no solution.

distributors for strong marketing performance are a staple of U.S. commerce. In this sense, the airline industry is not in any way unique.

Indeed, the NPRM states that the Department is “not finding that override agreements are anticompetitive.” *NPRM* at 69404. Thus, override agreements will remain a legal part of how airlines compensate travel agents for strong performance. Yet, the Department’s proposed regulation is intended, in part, to make these legitimate agreements far more costly to administer. At a time when airlines are losing millions of dollars every day, a regulation that creates increased costs for some competitors is particularly troublesome.

B. No Acceptable Justification Can Be Advanced for the Proposed Ban and No Evidence Can Be Found to Support It

The proposed ban on MIDT data does nothing to address CRS issues. Instead, it is specifically designed to advantage one group of airlines – the generally smaller point-to-point carriers that do not operate large networks and have not invested in information systems to utilize available market data – to the disadvantage of network carriers, like American, that have made these investment in technology.

The Department has stated that “regulating business conduct is not desirable unless clearly necessary” and that “regulation imposes costs of its own.” 57 Fed. Reg. 43780, 43783 (September 22, 1992). It has acknowledged that it may not prohibit conduct simply because that conduct has an impact on competition that the Department does not like, 65 Fed. Reg. 45551, 45554 (July 24, 2000), and that regulation should not be designed to “benefit a particular competitor.” 49 Fed. Reg. 11643, 11669 (March 17, 1984). The Department’s

proposed restriction of MIDT content is a severe departure from these regulatory standards.

The Department contends that “under general economic theory, the airlines’ ability to obtain detailed realtime data on their competitors would not promote competition.” *NPRM* at 69403. American strongly disagrees. One need not quarrel with Professor Kahn, upon whom the Department seems to rely, or his theory that in an oligopolistic industry prices may tend to converge even in the absence of any agreement. It may be true that, under some circumstances, market participants may be reluctant to cut prices if competitors will likely match any reduction and dilute any additional sales stimulated by the lower price. However, it may be equally true, under some circumstances, that competitors may be reluctant to cut prices if to do so may prompt ill-informed responses based on a poor understanding of changing market conditions. Given the performance of the airline industry, the later explanation is much more compelling.

Regardless of the merits of Professor Kahn’s opinion, his analysis has very little analog in how airlines use MIDT.⁴³ MIDT is information primarily concerning market demand. It is not pricing information. MIDT assists airlines in determining the most efficient and profitable allocation of their assets. In planning their networks, airlines relentlessly seek a greater share of the business at the expense of their competitors since in a mature industry, like the airlines, that is the only way an airline can grow. The present state of the industry plainly

⁴³ Dorman Affidavit at 14-15.

illustrates that this hyper-competitive drive by airlines for new markets and increased market share can often lead to overcapacity and lower prices for consumers – exactly the opposite of what concerned Professor Kahn.⁴⁴

In fact, Professor Kahn's concern with price visibility in an oligopolistic market argues for maintaining MIDT in its current form. As explained above, MIDT is the primary source of information that airlines, travel agencies, and corporations use to administer corporate discounts – which are the largest and most important segment of airline pricing that is not readily transparent to competitors. Regulation that makes this non-public discounting more expensive to administer, and therefore less attractive to airlines, creates the wrong incentive.

The other arguments and evidence cited by the Department in support of its proposed MIDT rule are equally unconvincing. The NPRM states that several airlines "contend that airlines use data to 'poach' customers already booked on another airline." *Id.* Since MIDT does not include passenger names it is difficult to understand how this alleged "poaching" has occurred, but, in any event, there is no evidence that this problem is so widespread as to justify the costly regulation proposed in the NPRM. If poaching is occurring, the appropriate response should be a lawsuit or an enforcement action, not a rule that introduces profound inequities and inefficiencies into the market.

Certainly, it is no surprise that some travel agencies and corporations would prefer that MIDT not exist. Although they voluntarily enter into agreements

⁴⁴ All of the other authorities cited by the Department, such as the ATPCo litigation, concern pricing information. None stand for the proposition that markets are better served when the

and accept payments and discounts from the airlines, they would benefit from regulations that made them less accountable for the performance of their obligations. That, however, is not a proper regulatory objective. *1992 Final Rule* at 43820.

The Department's primary motivation for this new regulation appears to be a desire to protect smaller carriers from competition by larger carriers. But Congress determined long ago that regulating competitive practices in the airline industry is bad policy, and the Department has acknowledged that it cannot regulate competitive practices even if it disagrees with or dislikes that conduct. The only exception to these regulatory standards is when the Department has a record that clearly shows conduct that violates antitrust laws or principles. That showing has not been made. Indeed, the evidence is to the contrary.

First, the current state of the industry has proven wrong any notion that new entrant carriers need assistance from regulation in order to compete. JetBlue, AirTran, Frontier, and other small carriers have financially outperformed the large network carriers, and in some cases have even been profitable, despite the extremely depressed market. The NPRM assumes, but never proves, that large network carriers are most prone to misuse MIDT to defend their hubs, but AirTran and Frontier have grown up in and outperformed the industry in two of the largest, most concentrated airline hubs, Atlanta and Denver. Airtran's financial performance is much better than Delta's, and Frontier's largest competitor, United, is in bankruptcy. This evident success -- which far exceeds the quality of any evidence cited in support of this regulation -- debunks any

competitors have less information about market demand or relative performance.

theory that MIDT and override agreements allow large airlines to forestall competitive challenges at their hubs.

Second, even if it were assumed (wrongly) that the smaller carriers needed the Department's regulatory assistance, degrading the quality of MIDT does very little, if anything, to assist that (improper) regulatory cause. Most new entrants and smaller carriers have adopted Southwest's strategy of minimizing the percentage of reservations coming via high-priced CRSs. They have a much higher percentage of direct bookings, and, indeed, this is one of their competitive advantages. Since those bookings are not made through a CRS, they are not included in MIDT. Simply stated, MIDT gives American a much clearer picture of its relative share versus Delta and United than it does against any of these new start-up carriers.

Given these facts, it is not surprising that the record is devoid of evidence that a small carrier has been victimized by a larger network carrier's use of MIDT. The Department contends that Legend made this allegation against American in an informal meeting with Department staff. Nothing in the record explains how Legend tried to substantiate its allegations, which are absolutely false. American unequivocally states for the record that it did not use MIDT to identify and target travel agencies that were selling Legend's services.

The antitrust laws have always prohibited predatory activity. Short of illegal conduct, however, the airline industry will remain a fiercely competitive industry for carriers large and small. Some carriers will select of a strategy of using their size, brand recognition, and established relationships with customers

and distributors to compete. Others will use their cost advantages, generally newer fleets, and flexibility to compete. The Department should not be placing its thumb on the competitive scales. The CRS regulations should remain focused on addressing the regulatory concern that led to their creation – CRS market power – not straying into the dangerous and inappropriate territory of regulating competitive conduct between airlines.

C. If the Department Restricts MIDT It Should
Adopt the Least Disruptive Regulation

As explained above, the Department's proposed restriction on MIDT is neither a wise nor valid exercise of the Department's regulatory authority. However, if the Department intends to pursue this regulatory path, it should adopt the least disruptive alternative that achieves its – albeit improper -- regulatory goal.

The Department's proposed rule of allowing an airline to obtain data on its own sales is no solution. That information -- which the airline already has -- offers an extremely truncated view of the market and provides no information whatsoever concerning potential new markets. Without information concerning overall market demand, airlines will find it more difficult to identify new markets or to measure the relative performance of their own sales initiatives – objectives that even the NRPM recognizes are entirely legitimate. The Department's proposed solution also does not alleviate the inefficiencies that would arise in the administration of override and corporate agreements.

If, as indicated by the NPRM, the Department is primarily concerned with larger network carriers using MIDT to identify and target agencies that are selling

the services of new entrants, it should break that information link, but nothing more. The Department can achieve that objective by a rule that precludes CRSs from giving the airlines the market share of individual competitors at the travel agency level. Under this alternative, airlines would be able to see competitor market share data at higher levels of aggregation, such as by city or airport code, but would be unable to identify which agencies within that geographical area were selling the greatest percentage of individual competitors services. Airlines would, thus, retain their ability to analyze overall market demand in planning their route structure and competitive initiatives, but they could not target individual agencies that are directing substantial business to other carriers.

Also, under this proposal, airlines would be able to see their own (but not their competitors') market share data at the agency level so that they can efficiently monitor override and corporate discount agreements. As explained above, there is no procompetitive benefit in interfering with contracts that the Department has not found to be anticompetitive, or in increasing airline costs of administering such contracts. American's proposed alternative has none of those adverse effects.

These suggested changes address the Department's stated regulatory objectives – as improper as they may be – but mitigate the disruption to airline route and marketing planning. It also allows airlines, like American, to continue to use the information systems that they developed based, in part, on the Department's long-standing refusal to restrict MIDT.

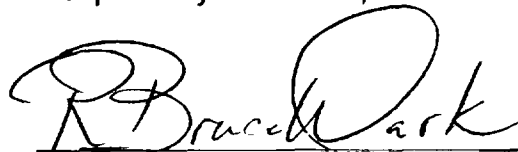
VII. Sunsetting the CRS Regulations

American is optimistic that CRS market power is on the wane. Although that day has not yet arrived, CRS market power is unlikely to be sustained over the long term, and American believes it would be a mistake for the Department to let another ten years go by before reconsidering the need for the CRS regulations. Thus, American proposes a three-year sunset date on the regulations, and we encourage the Department to begin soliciting comments at least one year before that date. American does not believe the public interest will be served by extending the regulations beyond three years in the absence of a compelling showing that regulation continues to be needed.

VIII. Conclusion

American appreciates the opportunity to comment on the Department's NPRM, and we encourage the Department to act promptly in making needed regulatory changes. American firmly believes that if the Department takes action on parity clauses and eliminates mandatory participation, productivity payments, and the ban on discriminatory pricing, it will accomplish its objective of addressing CRS market power without undue regulation. These should be the Department's priorities.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "R. Bruce Wark". The signature is fluid and cursive, with a large loop at the end.

R. BRUCE WARK
Senior Attorney
American Airlines, Inc.

March 17, 2003

EXHIBIT 1

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As Animation Goes Digital, Disney Fights For Its Crown

By LAURA M. HOLSON

GLENDALE, Calif., Feb. 9 — Rarely does Hollywood-style glamour spill into this suburban Los Angeles enclave. But as the animation industry's elite gathered here recently at the Alex Theater to toast their favorite films of 2002, champagne glasses were clinking. Or was it the sound of jagged nerves?

These are anxious times for film animators, whose business is being roiled by layoffs, new technology and tension between the industry's longtime leader, the Walt Disney Company, and its upstart

partner, Pixar Animation Studios.

At the Glendale party, Roy E. Disney, the nephew of Walt Disney and, for many people, animation's champion and heir, seemed cautious about what lies ahead.

"Since 'Toy Story,' there has been a change in the perception about what an animated film is," said Mr. Disney, the studio's vice chairman for feature animation, referring to the 1995 Pixar hit that was the first commercially successful computer-generated film. "I hate the word 'brand,' but I worry that it gets harder for us to distinguish ourselves."

Mr. Disney has reason to worry. Tomorrow, the Academy of Motion Picture Arts

and Sciences will announce nominations for the 2002 Oscars, including one for best animated feature. And there is formidable competition for Disney's own animation unit, once heralded as the gold standard with classics like "Snow White" and "Bambi," and in the early 1990's, "Beauty and the Beast" (1991), "Aladdin" (1992) and "The Lion King" (1994), still holder of the box-office record for an animated film.

But since the mid-90's, when Hollywood began to embrace computer technology, the only rule in animation these days is that there is no rule. Instead of the pains-

Continued on Page 6

Even as the Big Airlines Struggle, Computer Booking System Prospers

By SAUL HANSELL

As the airline industry heads closer to insolvency, it is no surprise that Sabre Holdings, the world's largest computer reservations system, is having a tough time.

Not only is overall travel down, but the rapid adoption of Internet travel booking is causing an even more rapid decline in the number of bookings through travel agencies, Sabre's main users. Making matters worse, Travelocity, Sabre's own online travel agency, has stumbled, ceding the leading position to Expedia.

But financially, Sabre is doing amazingly well. The company, which was separated from American Airlines in 2000, predicts that its revenue will fall by only a few percentage points this year. And its profit margins are still higher in this bleak year than airlines achieve even at their best. Indeed, Sabre has been able to raise the price it charges airlines to book each ticket by 3 percent, even as airfares fall.

Sabre in reality may be doing too well for its own good. The airlines have set their sights on its highflying profits and are seeking to bring them down.

"They charge exorbitant rates relative to the value they add," J. Scott Kirby, executive vice president for sales and marketing of America West Airlines, said of Sabre and its rivals. "It is a cost that we don't find justified."

The airline industry is fighting a battle on several fronts with Sabre and other reservations systems. Five big airlines started Orbitz, an online travel agency that is developing technology to bypass the reservations systems. Northwest Airlines already has a Web site that agents can use to book tickets for their clients directly, and America West is building one.

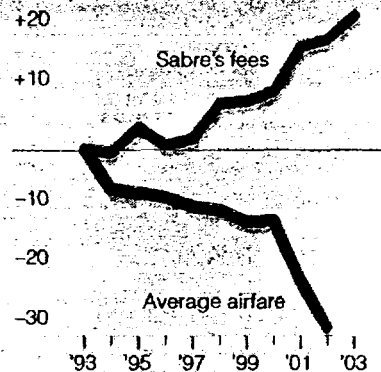
In all these cases, the airlines are pressing travel agents to cooperate by keeping their best fares off the common reservations systems, an action that undercuts the systems' big advantage — that they give

Continued on Page 2

Opposite Routes

Since 1993, the average fare for a 1,000-mile flight has dropped 30 percent, to \$120, even as Sabre's fee for its highest level of airline reservations service has risen by about 20 percent, to \$4.39. Figures are adjusted for inflation.

+30% since 1993



Sources: Air Transport Association, Sabre

The New York Times

Even as the Big Airlines Struggle, a Computer Booking System Prospers

Continued From First Business Page

agents one screen where they can book nearly any travel arrangement.

At the same time, the airlines have used their considerable lobbying power, persuading the Department of Transportation to propose eliminating some of the rules that help Sabre and its three rivals — Galileo, Worldspan and Amadeus — keep their fees up.

On the other end of this assault is William J. Hannigan, Sabre's chief executive. No stranger to tough conditions, Mr. Hannigan served as a Navy radioman on a fast-attack submarine. After a career with phone companies, he joined Sabre in December 1999, on the eve of its spinoff by AMR, American's parent.

Things started to deteriorate, with business travel in recession and then the Sept. 11 attacks and their economic aftermath. Mr. Hannigan responded by selling much of Sabre's computer operations to Electronic Data Systems and eliminating one-third of Sabre's jobs.

But he has continued to raise fees, rather than cut them as most airlines demand. His strategy is to exploit the reservations business, a cash cow, for as long as he can and use the money to build new lines of business, especially online travel.

The jury is out on whether this is a wise use of Sabre's cash. A new high-margin hotel product has yet to prove that it can revive Travelocity. And a \$757 million acquisition of GetThere, an Internet corporate travel site, is still losing money. Some investors would rather see Sabre pay a dividend than make more

acquisitions.

But there will be little cash for anything if the airlines make good on their pledges to revolt against the reservations fees. Sabre has introduced one discount program, but in general Mr. Hannigan asserts that Sabre's fees are worth every penny. Since Sabre mainly serves travel agencies that book business travelers, it sells much more profitable tickets than a site like Orbitz that draws bargain-hunting vacationers.

"I make no apologies for our pricing structure," Mr. Hannigan said from his office in Southlake, Tex. He said airlines sold \$80 billion worth of tickets on Sabre last year and its total revenue from those sales was \$1.5 billion, or about 2 percent.

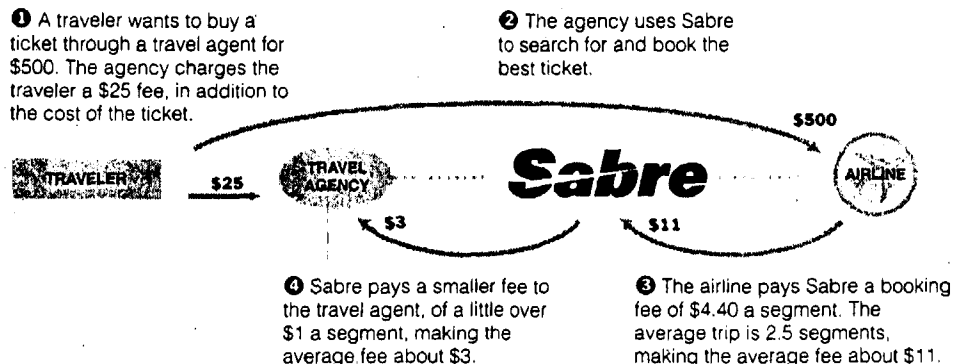
But the airlines argue that since 1993, Sabre's fees have increased in some cases by about 20 percent while airfares have fallen 30 percent. Moreover, executives at most airlines say they need to be in all the reservations systems to be available to all the travel agents. "We sell over \$5 billion a year through Sabre," said Craig Kreeger, vice president for sales at American. "If they increased their fee by 50 percent, I would probably have to pay it. I have absolutely no leverage."

Mr. Hannigan replies that the industry practices the airlines object to were all developed when Sabre was owned by American and its rivals were owned by other airlines. Worldspan and Amadeus are still controlled by airline groups. Galileo was bought by Cendant in 2001, a few years after it was spun off from United.

"It is a structure that was created by the airlines," he said, "and you

Booking Flights, Collecting Fees

Sabre and other reservations systems allow travel agents to compare and book flights on major airlines. Airlines argue that the fees they pay to reservations systems are far too high, particularly because a portion of the fee is rebated to travel agencies. Here is how it works.



The New York Times

always have to take it with a grain of salt when they complain about it."

And indeed the airlines are partly responsible for the current state of affairs. American started installing Sabre systems in travel agencies in 1976. At first, Sabre blatantly favored American flights, listing them before more convenient flights from other carriers. In 1984, the government imposed regulations to ensure the reservations systems treated all airlines alike.

Even after that, the airlines found a kind of "halo effect" — where agencies booked more flights on the airline that owned the reservations

system they used. That is why the airlines, not the travel agencies, pay for the systems. Indeed, the airlines instructed their own systems to woo agencies with free computers and later, cash payments referred to as incentives for each ticket sold.

The reservations systems paid for these incentives by raising the fees they charge airlines for each booking. And because of the way the government wrote its rules, the airlines decided they had little choice but to pay those higher fees.

Sabre says it has responded to the airlines' criticism with a program in which it will cut its fees 10 percent

for any airline willing to sign a three-year contract and give Sabre access to all its low fares, including those that had only been offered over the Internet. So far, only US Airways and a few small foreign carriers have accepted the deal.

Galileo has introduced a variation on that program that offered a 20 percent cut in booking fees, but only at agencies that agreed to waive about half of the incentive payment. In addition to access to Web fares, the agency gets extra commission on some of Cendant's brands like Avis car rental. US Airways and United have signed up for that deal.

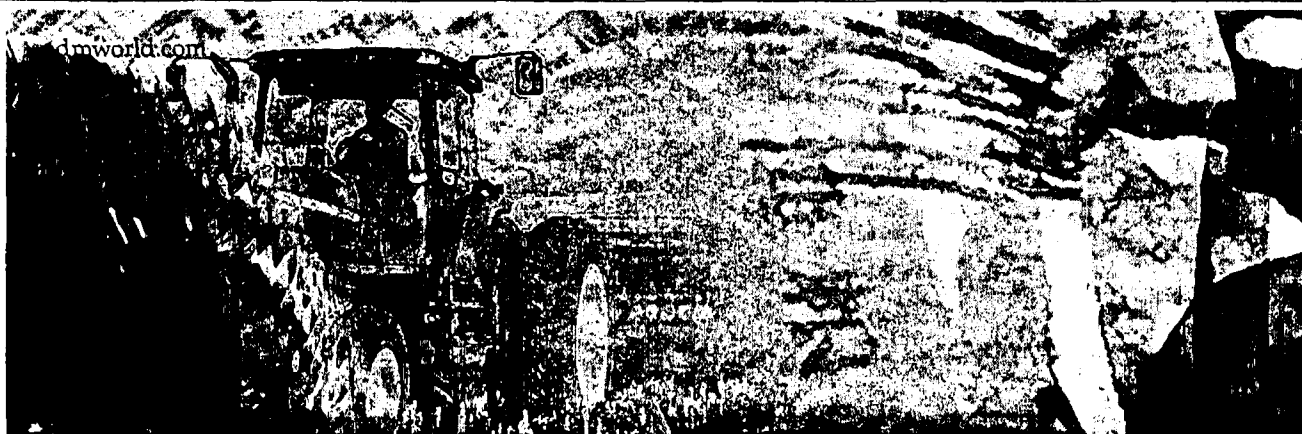
Most of the other big airlines say that even that the 20 percent cut proposed by Galileo does not go far enough. "Sabre and Galileo have the most to lose," said Al Lenza, vice president for distribution and e-commerce of Northwest. "They are taking baby steps in order to protect 95 percent of their revenue."

American has proposed its own program that would have agencies pay 50 percent of the booking fees in return for access to its Web fares. It says that 90 agencies have agreed.

Analysts say it may fall to the government sort all this out.

"I don't see the two sides coming to an agreement," said Scott Barry of Credit Suisse First Boston. "The airlines are from Venus and the reservation systems are from Mars."

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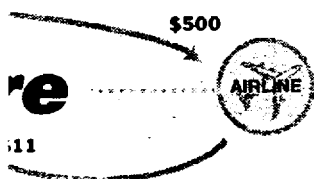
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book flights on major airlines. ph, particularly because a

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The airline pays Sabre a booking fee of \$4.40 a segment. The average trip is 2.5 segments, making the average fee about \$11.

The New York Times



Richard Patterson for The New York Times

William J. Hannigan, Sabre's chief, defends the fees charged airlines.

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Before the airlines commit to long-term deals, they are waiting to see the final rules proposed by the Transportation Department, perhaps later this year. The draft regulations, released last fall, read like an airline wish list — allowing big carriers to use their bargaining power. They would end the rule that reservations systems charge all airlines the same fee. And they would ban the incentive payments.

"The proposed new rules would significantly weaken the control of the reservation systems on the individual airlines," Mr. Lenza said.

Sabre says that a complete deregulation would be fine, but the proposal, which eliminates some rules and imposes others, does not create the proverbial level playing field.

"We say 'Regulate us; that's fine. Or deregulate us; That's fine. But we don't want to be stuck in the middle,'" Mr. Hannigan said.

Left unsaid is that those most likely to be disadvantaged are travelers. If the airlines go through with their threats to pull more of their best fares off Sabre and its rivals, it will be harder for the agents to find itineraries at the best prices.

That is one result, Mr. Kirby conceded, of America West's plan to bypass the reservations systems.

"Unfortunately, it will never be as convenient for travel agents as the current systems."

EXHIBIT 2

LAW OFFICES OF MARK PESTRONK, P.C.
THE TRAVEL LAW FIRM
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4041 UNIVERSITY DRIVE
FAIRFAX, VA 22030-3410

(703) 591-1900
FAX (703) 591-9116

MARK PESTRONK
(D.C. & VA)

EMAIL:
mpestronk@aol.com

TO: PRESIDENTS OF LARGE TRAVEL AGENCIES
FROM: MARK PESTRONK
DATE: FEBRUARY 7, 2003
SUBJECT: DOT'S PROPOSAL TO OUTLAW GDS BONUSES

I am writing to you, as president of a large travel agency, to solicit your participation in a coalition of large agencies to file a single set of comments in DOT's CRS rulemaking proceeding.

As you may have heard, DOT has proposed to change its CRS rules to outlaw segment bonuses and all other forms of agency compensation geared to usage of a CRS system. Unless DOT is persuaded to drop this misguided proposal, it will probably be adopted by the end of 2003.

To understand DOT's reasoning, it is useful to quote from the explanatory statement to the proposed rule:

"Our primary goal will be to prevent practices in the CRS business that would substantially reduce competition ... particularly practices that deny agencies and airlines the ability to use alternatives to a travel agency's present system."

One of these practices, DOT says, is productivity pricing, as:

"[I]t operates as the equivalent of the minimum use clauses that we prohibited when we last reexamined our rules.... It now appears that the systems have been using productivity pricing to ... encourage travel agencies to use one system for all or almost all of their bookings...."

"Productivity pricing appears to deter travel agents from using ... options to bypass the systems...."

Presidents of Large Travel Agencies

Page 2

February 7, 2003

Let you think that DOT is attacking only the system of quotas for free service and not segment bonuses, DOT notes:

"Ending productivity pricing would ... reduce the revenues of many travel agencies, especially the larger travel agencies."

As you can tell from the quotations, DOT's reasoning is very muddled. It does not understand that segment bonuses are purely a function of competition among the CRS vendors. Nor does it understand that the true villain is the high penalties charged for missing the quotas. By outlawing both the penalties and the bonuses, DOT will throw out the baby with the bath water. It will dry up the most reliable revenue stream that most large agencies have.

A. Course of Action

Accordingly, I propose to draft comments, which will be due March 17, 2003, and reply comments, which will be due May 15, 2003, on behalf of a coalition of larger agencies. We will be urging DOT to: (a) drop the proposed ban on segment bonuses or (b) just deregulate the terms of the GDS contracts altogether. Since it is highly unlikely that DOT will adopt the latter course of action, it will be particularly important to show DOT why segment bonuses are not anti-competitive.

B. Our Experience

We have formed this coalition twice before. In 1992, I was successful in filing comments which led to getting DOT to drop a similar proposal ban on productivity pricing when it outlawed "minimum-use clauses." In 1997 and 1998, when most U.S. carriers asked DOT to outlaw bonuses, we filed comments that DOT cited 22 times in the explanatory statement to the new proposal. Clearly, DOT pays attention to us.

If history is a guide, DOT's proposals will affect existing contracts as soon as they become effective. Therefore, if you recently signed a new five-year GDS contract, do not assume that the new rules will not affect your bonuses.

No other industry players have the same interest as large travel agencies. No vendor, third-party supplier, or travel-agent association has an interest in maintaining the current stream of bonus money based on supplier booking fees while removing some of the more anti-competitive practices of the vendors and their affiliated airlines.

C. Representation

Our flat fee will be \$2,000 per agency, and we need a minimum number of agencies to join the coalition in order to be viable.

If you decide to join, we will bill you for \$2,000 on April 1, and payment will be due within

Presidents of Large Travel Agencies

Page 3

February 7, 1963

30 days.

We propose to submit our 20- to 30 page comments on March 17 and our 10- to 20 page reply comments on May 15 on behalf of your agency, together with other large agencies who join the coalition. At your request, we will send you a draft of comments by March 10, and we will need your proposed revisions by March 13.

Your agreement to the terms of this letter will also represent your agreement that we may accept the same compensation from the other agencies who choose to have us represent them in drafting and/or submitting the comments.

II. Agreement

Please indicate your choice by checking the appropriate box below, signing below, and returning this page to me at (703) 591-5116 by February 21. Thanks.

1. ☐ I agree to the proposed terms and consent to have my agency's name used on the comments and disclosed to other members of the coalition.
2. ☐ I agree to the proposed terms, but wish to have my agency's name withheld from the comments and from the other members of the group.
3. ☐ I would like to discuss this with you further. Please call me, Mark.

Sincerely,

Mark Pestronk

Accepted and agreed:

Agency Name

By: _____

Title: _____

Printed Name: _____

Date: _____

EXHIBIT 3

AFFIDAVIT OF DR. GARY J. DORMAN

I. QUALIFICATIONS

My name is Gary J. Dorman. I am an economist and a Senior Vice President of National Economic Research Associates, Inc. (NERA), where I specialize in antitrust economics. I have conducted research on the airline industry during the past twenty-eight years and have published a number of articles on the subject. I have been a consultant on airline issues to the World Bank, the U.S. Civil Aeronautics Board (CAB) and numerous air carriers. I have testified as an expert witness on antitrust issues in the airline industry in various proceedings before the U.S. District Courts, the Canadian Competition Tribunal, the European Commission, the U.S. Department of Transportation and the U.S. Civil Aeronautics Board.

I have studied airline computer reservation systems (CRSs) during the past nineteen years and have written a number of reports concerning CRSs. I have testified as an expert witness on CRSs in various proceedings before the U.S. District Court for the Central District of California, the Canadian Competition Tribunal, the Court of Arbitration of the International Chamber of Commerce (London), and by affidavit before the U.S. Department of Transportation. My qualifications are described in detail in Attachment 1 to this affidavit.

NERA has been retained by counsel for American Airlines to address certain economic issues that have arisen in this proceeding. Over the years, I have provided consulting services and expert testimony to American Airlines and to Sabre in various matters. However, the opinions expressed in this affidavit are my own, and do not necessarily reflect the views of American Airlines or Sabre.

II. RECENT CHANGES IN THE INDUSTRY

A. Changes in the airline business

There have been important changes on both the demand side and supply side of the airline business, particularly since September 11, 2001. On the demand side, business travel has decreased in overall volume while business travelers have exhibited an increased elasticity of demand—i.e., greater price sensitivity. On the supply side, there has been rapid worldwide expansion of low-fare carriers such as Southwest, AirTran, JetBlue, WestJet, Ryanair and easyJet, driving down fares wherever they fly. The combination of these demand and supply factors has caused substantial declines in revenues for American and the other traditional network airlines.

B. Changes in the CRS business

All four of the current CRSs were initially developed and owned by airlines. A fundamental change has occurred in the CRS business with the airlines having spun off the three largest CRSs to non-airline owners. Sabre is now 100 percent publicly owned. Galileo is 100 percent owned by Cendant, itself a publicly-owned company. Amadeus is 40 percent publicly owned.¹ Worldspan's three airline owners—Delta, Northwest and American—have recently announced an agreement to sell their entire interest to a newly-formed company that has no airline ownership. As a consequence, Sabre, Galileo and Amadeus—soon to be joined by Worldspan—no longer share the economic interests of the airlines. They must answer to

¹ The remaining shares have been retained by three founding European airlines that currently hold 59.92% of the company: Air France (23.36%), Iberia (18.28%) and Lufthansa (18.28%). See www.amadeus.com/en/40/40.jsp.

public shareowners that expect growing revenues and profits rather than to airline owners that want low-cost, efficient distribution systems.

Another important change in the business is that CRS revenues have shifted away from CRS subscriber fees charged to travel agencies and toward CRS booking fees charged to airlines. This has become possible due to a shift in the balance of economic power between CRSs and airlines, as discussed in subsequent sections of this paper. Important consequences have been spiraling “productivity payments” (i.e., rebates) paid by CRSs to travel agencies, sustained by spiraling booking fees paid by airlines to CRSs. This has occurred despite the development and growth of a number of less-costly alternatives to the traditional travel agent/CRS distribution channel. The reasons are discussed in the following sections.

III. ECONOMIC FORCES IN THE CRS BUSINESS

A. Travel agency incentives

A key feature of the CRS business is that travel agencies select their CRS vendors, but it is the airlines that have to pay for those CRS services in the form of booking fees. The travel agencies have no incentive to choose among CRSs based on their levels of booking fees because the travel agencies do not pay them. In fact, travel agencies’ incentives are opposite to those of the airlines because a portion of the booking fees collected by CRSs is typically passed back to the travel agencies in the form of rebates. Consequently, higher booking fees can translate into higher rebates paid to travel agencies, while at the same time they impose higher distribution costs on airlines.

In this setting, travel agencies have no incentive to “conserve” on CRS services because most (measured by volume of bookings) get those services essentially for free. Indeed, travel

agencies effectively are paid to use the CRSs because booking fee rebates paid to travel agencies generally exceed their CRS subscription fees. Even if the internet could provide similar functionality to CRSs with respect to providing information (schedules, fares, seat availability), processing reservations (flight bookings, seat assignments, fare collection) and producing documents (itineraries, receipts, etc.), travel agents are not likely to use the internet unless they are somehow induced to give up their CRS “productivity” rebates.

It should be noted that travel agents’ heavy use of “free” CRS services closely parallels consumers’ heavy use of travel agencies. Under the regime that existed in this industry for many years, airlines paid high travel agency commissions. This meant that compensation for travel agency services was built into airline fares, whether used by consumers or not. Thus, travel agency services were viewed as “free” to consumers.

With the reduction and eventual elimination of base commissions, travel agencies have generally moved to a fee-for-service model. Naturally, these fees have discouraged some consumers from patronizing travel agencies, instead choosing lower-cost or free distribution services such as third-party and airline websites or 1-800 airline reservation lines. The general principle underlying these changes in travel agency compensation is that direct-purchasing consumers should not be made to subsidize those who wish to use travel agents, just as investors who choose low-cost internet stockbrokers should not be forced to pay higher fees to subsidize those investors who prefer full-service stockbrokers.

B. CRS codes of conduct

In the 1980s, the U.S. and the EU adopted codes of conduct for CRSs. These rules were originally aimed at preventing potential abuses by airlines that owned CRSs, which might take

the form of a CRS owner using its position as an airline to disadvantage other CRSs, or an airline using its position as a CRS owner to disadvantage other airlines. While there have been some modest amendments over the years, the key provisions remain: (1) anti-bias rules eliminating computer screen preferences and other forms of discriminatory treatment of airline information; (2) mandatory participation rules requiring CRS-owning airlines to participate equally in all CRSs; and (3) uniform booking fee rules preventing preferential deals between individual airlines and CRSs.

The separation of ownership of CRSs and airlines has largely removed the concerns that fostered these rules. Indeed, the rules are now an impediment to the functioning of normal market forces that might otherwise help to limit booking fee increases over time. As discussed below, the consequence of the dual requirements of mandatory participation by CRS owners and uniform booking fees across all airlines is that no airline has the ability to bargain individually for lower booking fees. While the original intent of the rules was to preserve and promote competition between CRSs, the current outcome is that they suppress competition between CRSs from the perspective of the airlines.

C. CRS alternatives

While some travel agency locations use more than one CRS, the travel agency subscriber lists for the four CRSs are sufficiently distinct that an airline's participation in any one of the four cannot substitute for its participation in any of the remaining three CRSs. Because of these differences among the four subscriber bases, withdrawing from one CRS, even if allowed under the U.S. and EU rules, would today almost certainly cost an airline more in lost ticket revenues initially than any savings it might achieve on booking fees. And even if

an airline could recapture those “lost” bookings through another CRS, its total booking fees would not decline because all four CRS vendors charge similar prices. There is no low-priced CRS vendor and, under current circumstances, there is no incentive for any of the four vendors to lower its booking fees.

In other industries, suppliers can deal with distinctions in clientele among alternative distribution channels by means of differential pricing. This may entail the use of incentives such as discounts to convince consumers to change their shopping patterns. It may also involve incentives such as promotional allowances to induce retailers or other intermediaries to change their distribution practices. These incentives, which often take the form of differential pricing, stimulate competition among distribution channels, and consumers in such markets are the ultimate beneficiaries. In this industry, however, with the CRS rules and uniform published fares across all CRSs, airlines have virtually no ability to influence travel agency CRS choices and only a limited ability to influence consumer choices among ticket distribution channels (using such methods as web-only fares or online booking bonuses).

There do exist some substitution possibilities from the airline perspective: direct reservations, airline websites and certain third-party websites such as priceline.com. These all involve substitution for the entire travel agent/CRS distribution channel, not just for CRSs alone. While the trend is toward more internet and direct bookings of airline tickets, it clearly has not been sufficient to constrain the ever-rising levels of booking fees charged by the CRS vendors. Over time, as American Airlines’ internet penetration increases, it may become less important for American to be present to the same extent in every CRS. The CRS rules, however, require airlines that own CRSs to participate at the same level in all CRSs. “Parity

clauses” in the participating carrier agreements between CRS vendors and airlines impose similar requirements—even on airlines that do not own a CRS.

Lower-cost alternatives to the existing CRSs that could be used by travel agencies may be unlikely to develop. This is because travel agencies rely on their CRS booking fee rebates as a revenue source, and they probably would not use the internet as a substitute unless they are induced somehow to give up those rebates. The escalating levels of rebates that the CRS vendors pay to travel agencies suggest that the vendors view switching by travel agencies from one CRS to another as a real possibility. This does not, however, demonstrate that switching would occur in response to a major airline’s withdrawal from one CRS. It only shows that travel agencies may threaten to switch in response to the competing financial incentives offered to them by the CRS vendors.

D. CRS booking fees

At present, there is no incentive for the CRS vendors to compete by reducing their booking fees. A unilateral cut in its booking fee would not result in greater booking volumes for an individual CRS, but would reduce its ability to pay rebates to travel agencies. Those lower rebates would likely cause a reduction in its travel agency subscribers and thereby a reduction in its bookings and booking fee revenues. This disincentive to reduce booking fees is compounded by the mandatory participation rule and the requirement of uniform booking fees for all airlines. Moreover, given the already high market penetration of CRSs among travel agencies, the rebates paid by CRS vendors do not benefit the airlines by automating more agencies and thereby enhancing ticket distribution. Instead, these rebates are effectively a zero-sum game among CRSs that ultimately transfers substantial airline revenues to travel agencies.

American Airlines has no realistic options but to acquiesce to booking fee increases, since it has two unattractive alternatives. First, under the existing CRS rules, it could reduce its participation level in another CRS—as long as it also did so in Worldspan. (This may be prohibited under the “parity clauses” in the participating carrier agreements between CRS vendors and airlines.) While this may lower its booking fees somewhat, it is likely to be a poor business decision because the loss in revenues from lower ticket sales would probably be significantly greater than the savings in booking fees. Second, under the existing CRS rules, it could withdraw completely from another CRS as long as it also withdraws from Worldspan, which undoubtedly would cause massive revenue losses relative to the booking fees saved.

Without the combination of the mandatory participation rule and the requirement of uniform booking fees, an airline could reduce its level of participation or withdraw completely from an individual CRS—or at least use the threat of doing so—to negotiate for lower booking fees. This is what would likely happen in an unregulated CRS market. While there would be a significant cost to any major network airline that implemented this strategy, it could put pressure on a CRS to reduce its booking fee to that airline, rather than risk lost bookings and a possible loss of travel agency subscribers because its CRS service would be degraded. Such a scenario might represent a cost-effective strategy to reduce booking fees—but only if a CRS could respond by reducing its fee to an individual airline, a practice prohibited under the current CRS rules.

The non-discrimination rule insulates the CRSs from having to negotiate with their airline customers, thereby encouraging cartel-like behavior that stabilizes booking fees at high levels. Such pricing practices would not likely survive in a competitive marketplace. In fact,

volume discounts and individually-negotiated prices are commonplace in many competitive industries, and they tend to benefit all buyers by undermining rigid pricing structures that would otherwise suppress price competition. The rules that ban them in the CRS business are an intrusion on an important market mechanism that ordinarily would help to restrain booking fee increases, with the result that all airlines are required to pay high prices.

Attempts to justify this market intervention often refer to the need to “protect” smaller airlines from having to pay higher booking fees than those that the larger airlines might be able to negotiate. If the requirement of uniform booking fees were to be repealed, it is not clear that smaller carriers would pay significantly more than larger carriers. Although the former may lack large passenger volumes, smaller carriers may have similar bargaining strength. This is because direct distribution alternatives such as the internet and 1-800 telephone reservation lines are close substitutes for travel agents from the perspectives of many of the customers of the smaller carriers. Such carriers typically offer mainly point-to-point services, have simpler route and fare structures, and do not provide international travel—all of which reduce the need for travel agency services.

The most successful smaller carriers derive a high proportion of their revenues from direct sales. In other words, the bargaining power of smaller airlines may be based less on their passenger volumes and more on their distribution alternatives, and may well be more effective than the bargaining strength of larger carriers. Moreover, CRS vendors will want to retain the business of smaller carriers because it lowers their CRS unit costs and increases the attractiveness of their CRSs to travel agencies. In any event, there is no basis to assume that smaller carriers will pay even higher booking fees than those already established by the CRS

vendors, or that smaller carriers are best protected by imposing high booking fees on the larger carriers.

Rather than protecting airlines, the uniform pricing rule quashes any incentives for CRSs to attract incremental business by offering booking fee discounts for incremental bookings. That would represent a pro-competitive CRS practice that is prevalent in virtually all other travel-related businesses. The consequence of all these economic factors is that the CRS vendors are able to charge high booking fees and to implement annual price increases with few competitive constraints. Indeed, there is no evidence that CRS booking fees are related to the actual costs of the vendors.

E. Harm to airlines

High CRS booking fees harm the airlines, particularly the traditional network airlines that distribute a large proportion of their tickets through travel agencies. Increasingly in the airline industry, ticket prices are determined by the low-fare carriers that generally bypass the travel agency channel in favor of lower-cost distribution channels. The result is that traditional network airlines must absorb a substantial portion of the booking fees in order to remain competitive on pricing. If they try to pass along the ever-rising booking fees to their customers, they will often lose business to low-fare airlines that can avoid CRS booking fees.

The high booking fees exploit airlines that are in the midst of a financial crisis. The recent pattern of severe losses by traditional network airlines must be reversed. Without the necessary cost savings, many of these network carriers will disappear. This will be to the detriment of consumers, who will have fewer competitive choices, as well as to the detriment

of the global transportation network, which cannot be sustained solely through point-to-point airlines that have limited route structures and do not interline with other carriers.

Ironically, the high booking fees are weakening the very carriers that are most dependent on travel agencies for distribution. The threat to the survival of traditional network carriers is also a direct threat to the travel agencies and the CRS vendors that equip them. Moreover, consider the short-term responses by the CRS vendors to the shrinkage of traditional carriers and the resulting decline in the volume of CRS bookings. They may react by increasing booking fees to even higher levels while raising incentive payments to travel agents to gain more of a shrinking pie—thereby causing the pie to shrink still further.

IV. INFORMATION AND THE ROLE OF MIDT

A. Benefits of information

It is widely recognized by economists that the availability of accurate and timely information will generally improve the functioning of markets. On the supply side of a market, better information allows producers to more closely tailor their products (or services) and prices to satisfy the needs of consumers. On the demand side of the market, better information allows consumers to compare the relative merits and prices of various products (or services) and to identify those that best meet their needs.

This is not to suggest that more information will universally and unambiguously improve the functioning of markets. First, information is generally costly to collect and process, and is subject to diminishing returns. This means that beyond a certain point, the costs of providing more information will outweigh the benefits. Second, it is possible to hypothesize market conditions under which more information may actually enable, or at least encourage,

non-competitive outcomes. One example might be the availability of information about competing bids prior to the award of a contract in a sealed-bid competition. Another possible example, suggested by Professor Alfred Kahn, was cited in the NPRM (at 69403) and is discussed below.

In the case of the airline industry, the increasing availability to consumers of real-time information on schedules, fares and seat availability has unquestionably led to more intense competition among airlines. This has been brought about largely through two technological revolutions: (1) beginning in the 1980s, the development of CRSs, which provide a wide range of airline information to travel agents and, indirectly, to consumers; (2) beginning in the 1990s, the development of the internet, which provides a greater breadth and depth of airline information directly to consumers.

B. Benefits of MIDT

One issue raised in the NPRM at 69401-69404 is whether the present composition and distribution of MIDT information has had the effect of distorting or suppressing airline competition. A preliminary observation is that the industry today shows no signs of a lack of competition—prices are low and monopoly profits are nowhere in evidence. Moreover, the types of airlines claimed to be disadvantaged by current MIDT practices—particularly smaller, lower-cost carriers—generally are outperforming the larger network airlines said to be the primary beneficiaries of MIDT.

Airlines use MIDT for two main purposes: route planning and sales initiatives. For network carriers, MIDT constitutes the best available source of data on market demand. It is superior to the DOT-mandated origin-destination (O&D) data because of its timeliness and the

fact that it represents reasonably complete data for the travel agency distribution channel, as contrasted with the sample data from which the O&D survey is constructed. MIDT is somewhat less useful to low-cost, point-to-point carriers because they generally emphasize direct distribution of their tickets. This results in smaller proportions of their passengers using travel agents, which is the distribution channel represented in MIDT.

Accurate and timely data on demand are especially important in the airline industry because it supplies a perishable product that cannot be inventoried. Once a flight departs, any potential revenue from empty seats is lost forever. Route planners must therefore optimize their schedules without the possibility of placing excess product into inventory—an option available to most other industries. A diminution in the timeliness, breadth or accuracy of the available MIDT data may cause a significant decline in the performance of network carriers, to the detriment of their customers as well as their employees and stockholders.

The second major use of MIDT is for airline sales initiatives, especially travel agency incentive (override) programs and corporate discount programs. MIDT is considered to be the most efficient way for airlines to monitor their agreements with travel agents, and is used to manage some corporate accounts as well. Without access to certain MIDT data disaggregated to the level of an individual travel agency, such incentive programs would become more burdensome for airlines and travel agencies to administer. The likely consequence is that incentive programs would become more costly—and therefore less attractive—to airlines, with those higher costs ultimately passed along to travel agents (in the form of reduced incentive payments), consumers (in the form of higher travel agent fees) and corporate customers (in the form of lower discounts).

As recognized in the NPRM at 694404, overrides are a valid form of competition with analogs in other industries: "We are not finding that override commission programs are anticompetitive. Firms commonly may reward distributors for producing higher sales." Yet the NPRM goes on to suggest that "the proposed changes could additionally promote competition by weakening the ability of the largest airlines to use incentive commission programs that leverage an existing dominant market share to obtain a larger market share." If the Department has now determined that override programs are anticompetitive, then it should ban them directly rather than adopting the indirect approach of raising their costs to make them less attractive to airlines. Conversely, if overrides are not viewed as anticompetitive, then adopting rules that raise their administrative costs serves no useful purpose and merely harms airlines, travel agents and consumers.

This issue leads back to the previous discussion of the possibility that more information may actually enable, or at least encourage, non-competitive outcomes. As noted above, the NPRM (at 69403) includes a lengthy passage from Professor Alfred Kahn:

[T]here is the familiar fact that in an oligopolistic industry, the negotiation of special, preferably secret deals with large buyers or distributors in a position to threaten to supply their own needs or take their business elsewhere is a particularly effective form of competition, reflecting an exercise of countervailing power on the buying side of the market, in an oligopoly whose members will typically be reluctant to cut prices openly and across the board; and that the prohibition of any such special deals or a requirement of their full disclosure and equal availability, in advance, to all comers, will discourage it.

The NPRM (at 69403) cites Professor Kahn's statement in support of the proposition that "keeping fares and sales secret from competitors can further competition in the airline industry." The NPRM does acknowledge that Professor Kahn's statement was made in a

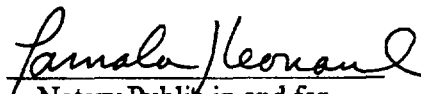
“somewhat different context, the question of the competitive impact of Orbitz and its most-favored-nation clause.” Yet it appears to miss the central lesson of Professor Kahn’s statement:

[T]he negotiation of special, preferably secret deals *with large buyers or distributors*...is a particularly effective form of competition...and that the prohibition of any such special deals or a requirement of their full disclosure and equal availability, in advance, to all comers, will discourage it. [emphasis added]

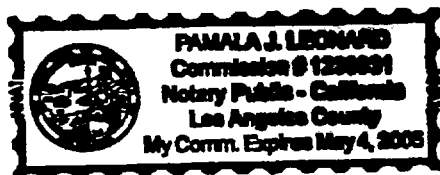
The two key points that apply to this CRS proceeding are: (1) corporate discounts and travel agency incentive programs—i.e., secret deals with large buyers and distributors—can be an effective form of competition; and (2) a prohibition of such deals—or rules that make such deals more difficult to administer—will discourage competition.


Gary J. Dorman

Sworn to and Subscribed before me on this 10th day of March, 2003.


Notary Public in and for
the State of California

My commission expires: May 4, 2005



NATIONAL ECONOMIC
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ATTACHMENT 1 TO THE AFFIDAVIT OF
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(8 PAGES)

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Dr. Dorman received a B.A. with high distinction and high honors in Economics from the University of Michigan and a Ph.D. in Economics from the University of California at Berkeley. His specialties include industrial organization and microeconomic theory.

His work at NERA has covered a wide range of antitrust and trade regulation matters in dozens of industries. He has studied relevant markets, mergers and acquisitions, predatory pricing, tying and bundling, price fixing, vertical restraints, exclusive dealing, essential facilities, joint purchasing, franchising, and antitrust damages. In addition, Dr. Dorman has analyzed economic damages in numerous commercial litigations. He has testified as an expert witness in U.S. district courts and state courts, as well as in matters before the U.S. Department of Transportation, the Competition Tribunal of Canada, the European Commission, and the Competition Council of France.

Dr. Dorman specializes in airline and aerospace economics and has extensive experience on a wide range of projects. In the airline industry, these include studies of airline mergers, code-sharing arrangements and alliances, acquisitions of route authority and airport slots, pricing practices and revenue management, hub-and-spoke operations, computerized reservation systems, frequent flyer programs, travel agency commissions, air cargo, aircraft leasing, valuation and bankruptcy issues, and the effects of airline regulation and deregulation. In the aerospace industry, he has conducted economic studies of the commercial airplane, helicopter, aircraft engine, avionics, aircraft modification, satellite and launch vehicle businesses, as well as military aircraft and weapons systems. Clients have included U.S. and foreign airlines, aerospace manufacturers, the U.S. Civil Aeronautics Board, state governments, and the World Bank.

Before joining NERA, Dr. Dorman was on the faculty of the University of Maryland. He also served as an economist at the U.S. Department of Energy and at the National Telecommunications and Information Administration, an agency of the U.S. Department of Commerce.

Dr. Dorman wrote *Air Transportation Regulatory Reform*, published by the American Enterprise Institute, as well as other papers on the airline industry. He has published several articles in *The Antitrust Bulletin*, including "The Boeing / McDonnell Douglas Merger: the Economics, Antitrust Law and Politics of the Aerospace Industry." He has served as an Editorial Consultant for *The American Economic Review* and is a member of Phi Beta Kappa.

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National Economic Research Associates, Inc., 1980-present
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U.S. Department of Commerce, 1979-1980
Senior Economist, Office of Policy Analysis and Development, National
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U.S. Department of Energy, 1978-1979
Staff Economist, Policy and Evaluation (on leave from University of Maryland)

University of Maryland, 1976-1979
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National Economic Research Associates

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Editorial Consultant for The American Economic Review, 1977-1981

Consultant to Office of Economic Analysis, U.S. Civil Aeronautics Board, 1977-1978

SELECTED PUBLICATIONS

"Implementing Price/Cost Tests for Predation: Practical Issues," Antitrust Report, Matthew Bender & Company (member of the LexisNexis Group), May 2002

"The Boeing/McDonnell Douglas Merger: The Economics, Antitrust Law and Politics of the Aerospace Industry," with T. Boeder, Antitrust Bulletin, Spring 2000

"Monopsony Revisited: A Comment on Blair & Harrison," with J. Jacobson, Antitrust Bulletin, Spring 1992

"Joint Purchasing, Monopsony and Antitrust," with J. Jacobson, Antitrust Bulletin, Spring 1991

"A Model of Unregulated Airline Markets," in Research in Transportation Economics, Volume 1, edited by T. Keeler, JAI Press, 1983

Review of Airline Deregulation: The Early Experience, by J. Meyer, et al., in Journal of Economic Literature, March 1983

Air Transportation Regulatory Reform, American Enterprise Institute for Public Policy Research, Washington, D.C., March 1978

MEMBERSHIPS

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FELLOWSHIPS AND HONORS

Faculty Research Award, University of Maryland, 1977

Sloan Transportation Fellowship, University of California, Berkeley, 1975-1976

William H. Probert Scholarship, University of California, Berkeley, 1972-1973

Sims Senior Honors Scholar in Economics, University of Michigan, 1971-1972

TESTIMONY IN THE COURTS

1. Petroleum Sales, Ltd., et al. v. Earth Resources of Alaska, Inc., et al.,
Superior Court of the State of Alaska, Case No. 4FA-79-902, by affidavit: 1980
2. A. J. Canfield Company v. The Coca-Cola Company, et al.,
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9/30/83, 11/2/83, 11/3/83
3. Nelson v. Piping Rock Club, et al.,
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1/9/85
4. Sun-Drop Bottling Company, et al. v. Coca-Cola Bottling Company Consolidated,
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deposition: 1/28/86, 1/29/86, 1/30/86; at trial: 5/28/86, 5/29/86
5. Federal Trade Commission v. The Coca-Cola Company,
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7/8/86
6. Sewell Plastics, Inc. v. The Coca-Cola Company, et al.,
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affidavit: 9/28/87, 11/5/87, 11/19/87; by deposition: 11/29/88, 11/30/88, 12/1/88,
1/4/89, 1/5/89, 1/6/89
7. In Re Air Passenger Computer Reservation Systems Antitrust Litigation,
U.S. District Courts, MDL 667 ER (Tx), by deposition: 11/13/87, 12/8/87, 12/9/87; by
declaration: 1/12/88, 1/28/88, 3/24/88, 10/20/89; at trial (Central District of
California): 11/8/89, 11/9/89, 11/29/89
8. Wendy's International, Inc. v. Pepsico, Inc.,
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8/9/88, 8/10/88

9. Coca-Cola Bottling Company of Elizabethtown, Inc., et al. v. The Coca-Cola Company, U.S. District Court (District of Delaware), Case No. 81-48-MMS, by deposition: 8/17/88, 12/2/88, 12/3/88; at trial: 12/13/88, 12/14/88; at retrial: 2/15/90
10. Pacific Express, Inc. and Pacific Express Holding, Inc. v. United Air Lines, Inc., U.S. District Court (Central District of California), Case No. CV 84-5185-ER (Mcx), by declaration: 7/16/90, 11/8/90; by deposition: 7/18/90
11. Contractors Equipment Company v. Gehl Company, et al., Superior Court of the State of California (County of San Diego), Case No. 614335, by deposition: 12/20/90; at trial: 5/21/91
12. In Re Domestic Air Transportation Antitrust Litigation, U.S. District Court (Northern District of Georgia), Master File No. 1:90-CV-2485-MHS & MDL No. 861, by affidavit: 3/1/91, 5/28/91; at hearing: 6/5/91
13. Watts Health Foundation, Inc. v. Arthur Andersen & Co., et al., Superior Court of the State of California (County of Los Angeles), Case No. C 657708, by deposition: 5/29/91, 5/30/91, 6/10/91, 6/11/91, 6/24/91
14. In Re Nintendo Antitrust Litigation, U.S. District Court (Southern District of New York), Civil Action No. 91 Civ. 2498 (RSW), by affidavit: 9/12/91; at hearing: 9/26/91
15. Taco Bell Corp. v. Specialized Bicycle Components, Inc., Superior Court of the State of California (County of Orange), Case No. 634983, by deposition: 11/13/91
16. DM II, Ltd., et al. v. Hospital Corporation of America, et al., Superior Court of the State of Georgia (County of Muscogee), Case No. 88C-3076, by deposition: 9/22/92
17. Continental Airlines, Inc. v. American Airlines, Inc. and AMR Corp. and Northwest Airlines, Inc. v. American Airlines, Inc. and AMR Corp., U.S. District Court (Southern District of Texas), Civil Action Nos. G-92-259 and G-92-266, at hearing: 3/1/93; by deposition: 5/26/93, 5/27/93; at trial: 7/29/93, 7/30/93, 8/2/93
18. The State of New York v. The Keds Corporation, et al., U.S. District Court (Southern District of New York), Civil Action No. 93 Civ. 6708 (CSH), by affidavit: 1/19/94
19. P.C. Holding, Inc., et al. v. Arthur Andersen & Co., Superior Court of the State of California (County of Los Angeles), Case No. VC012081, by deposition: 5/5/94, 5/6/94

20. The Roman Catholic Bishop of San Diego, et al. v. The Reader's Digest Association, Inc. and OSP, Inc.,
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21. Noise Reduction, Inc., et al. v. Nordam Corp., United Technologies Corp., The Boeing Company, et al.,
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22. Litton Systems v. Honeywell, Inc.,
U.S. District Court (Central District of California), Case No. CV 90-4823 MRP, by deposition: 8/14/95, 8/15/95, 8/16/95, 10/4/95; at trial: 1/8/96, 1/9/96, 1/10/96, 1/11/96, 1/12/96
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24. Blind Design, Inc. v. Hunter Douglas, Inc., et al.,
Superior Court of the State of California (County of San Diego), Case No. 686230, by declaration: 2/20/97; by deposition: 2/28/97, 3/1/97
25. PepsiCo, Inc. v. Steak 'n Shake, Inc.,
U.S. District Court (Southern District of Indiana), Case No. IP-95-580-C-B/S, by deposition: 8/26/98
26. Electric Lightwave, Inc. v. U S West Communications, Inc.,
U.S. District Court (Western District of Washington), Case No. C97-1073Z, by deposition: 1/15/99; at arbitration: 2/24/99, 2/25/99
27. PepsiCo, Inc. v. The Coca-Cola Company,
U.S. District Court (Southern District of New York), Case No. 98 Civ. 3282 (LAP), by declaration: 11/12/99, 2/15/00; by deposition: 8/22/00, 8/23/00
28. Epicenter Recognition, Inc. v. Jostens, Inc.,
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29. United States v. AMR Corporation, American Airlines, Inc., et al.,
U.S. District Court (District of Kansas), Case No. 99-1180-JTM, by deposition: 10/24/00, 12/14/00, 12/15/00; by declaration: 1/4/01

30. MetroNet Services Corp., et al. v. U S West Communications, Inc.,
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deposition: 1/26/01
31. Wolens, et al. and Gutterman, et al. v. American Airlines, Inc.,
Circuit Court of Cook County Illinois, Case Nos. 88 CH 7554, 89 CH 119, 95 CH 982
(consolidated), by affidavit: 2/14/01; at hearing: 4/6/01

**TESTIMONY BEFORE THE U.S. CIVIL AERONAUTICS BOARD (CAB)
AND THE U.S. DEPARTMENT OF TRANSPORTATION (DOT)**

1. Chicago-Midway Low-Fare Route Proceeding,
CAB Docket #30277, by written testimony: 1/23/78; at hearing: 2/10/78
2. Transcontinental Low-Fare Route Proceeding,
CAB Docket #30356, by written testimony: 3/30/78; at hearing: 4/19/78
3. California-Nevada Low-Fare Route Proceeding,
CAB Docket #31574, by written testimony: 4/10/78
4. Application of Eastern Air Lines, Inc. for Approval of Acquisition of Control of
National Air Lines, Inc.,
CAB Docket #34226, by written testimony: 2/21/79; at hearing: 2/22/79, 2/23/79
5. Texas International-Continental Acquisition Case,
CAB Docket #39285, by written testimony: 5/8/81; at hearing: 5/19/81, 5/20/81
6. Pacific Division Transfer Case,
DOT Docket #43065, by written testimony: 7/16/85; at hearing: 8/12/85
7. NWA-Republic Acquisition Case,
DOT Docket #43754, by written testimony: 4/24/86; at hearing: 4/30/86, 5/1/86
8. U.S.-London Gateways Case,
DOT Docket #44432, by written testimony: 12/9/86; at hearing: 1/8/87
9. In Re Computer Reservations Systems,
DOT Docket #46494, by affidavit: 1/4/90
10. Notice of Proposed Rulemaking, Computer Reservations System Regulations,
DOT Docket #OST-96-1145 (49812), by affidavit: 10/2/96

TESTIMONY IN OTHER PROCEEDINGS

1. Testimony before the New York State Senate Finance Committee and Assembly Ways and Means Committee, Joint Hearing on the State Operations and Capital Projects Budgets, at hearing: 1/22/86
2. Testimony before the New York State Senate Finance Committee and Assembly Ways and Means Committee, Joint Hearing on the State Operations and Capital Projects Budgets, at hearing: 1/25/88
3. Testimony before the Competition Tribunal of Canada, In the Matter of the Combination of the Reservec and Pegasus Computer Reservation Systems into the Gemini Group, CT-88/1, by written testimony: 3/9/89, 3/22/89, 4/20/89; at hearing: 4/27/89
4. Testimony before the Competition Tribunal of Canada, In the Matter of an Application by the Director of Investigation and Research under Section 106 of the Competition Act, R.S. 1985, c. C-34 to Vary the Consent Order of the Tribunal Dated July 7, 1989, CT-88/1, by written testimony: 1/18/93, 1/28/93; at hearing: 2/12/93
5. Testimony before the American Arbitration Association, In Re American Airlines, Inc. and Association of Professional Flight Attendants, 1994 Interest Arbitration, at hearing: 10/19/94
6. Testimony before the European Commission, British Airways/American Airlines Alliance, Case No. IV/36.089, at hearing: 2/3/97, 2/4/97
7. Testimony before the European Commission, Boeing/McDonnell Douglas, Case No. IV/M.877, at hearing: 6/12/97, 6/13/97
8. Testimony before the Court of Arbitration of the International Chamber of Commerce, London, In the Matter of an Arbitration between Worldspan, L.P. and Abacus Distribution Systems Pte Ltd. and others, by written testimony: 12/4/98, 3/5/99; at hearing: 5/17/99
9. Testimony before the Competition Council (Conseil de la concurrence) of France, Related to the Concentration between the Boeing Company and the Jeppesen Group, A 333, by written testimony: May 2001; date of hearing: 6/12/01
10. Testimony before the Competition Tribunal of Canada, In the Matter of an Application by the Commissioner of Competition under Section 79 of the Competition Act, R.S.C. 1985, c. C-34, as Amended; And in the Matter of the Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service, SOR/2000-324 Made Pursuant to Subsection 78(2) of the Competition Act; And in the Matter of Certain Practices of Anti-Competitive Acts by Air Canada, CT-2001/002, by affidavit: 8/3/01, 8/20/01, 11/11/02, 11/25/02; at hearing: 1/23/03, 1/24/03, 1/27/03, 1/28/03

EXHIBIT 4

Press Releases

1. FD (FAIR DISCLOSURE) WIRE (12.13.02) Event Brief of Sabre Holdings 2003 Financial Outlook Analyst Conference Call - Final

CORPORATE PARTICIPANTS

. Bill Hannigan, Chairman & CEO . Karen Fugate, VP of IR . Jeff Jackson, CFO . Sam Gilliland, President & CEO of Travelocity

OVERVIEW

4Q02 EPS estimate to be in the range of \$0.12-0.15 before special items vs. previous estimate of \$0.20-0.25. Before special items, 2002 EPS forecast will be adjusted from \$1.85-1.95 to \$1.77-1.80. Q&A Focus: Expectations, cost reduction programs, Travelocity, etc.

FINANCIAL DATA

A. Key Data From Call 1. 4Q02 EPS estimate = \$0.12-0.15 before special items. 2. 2002 EPS forecast = \$1.77-1.80 before special items. 3. Expected EBITDA = \$430m. 4. Forecast for free cash flow = \$250m. 5. Projected EPS for 2003 before special items = \$1.78-1.88. 6. On a GAAP basis, EPS for 2003 = \$1.54-1.64. 7. Projected CAPEX for 2003 = \$90-100m. 8. Expected cash balance at the end of 2003 = \$1.1b.

PRESENTATION SUMMARY

S1. BUSINESS OVERVIEW (B.H.) 1. 2002 continues to be a challenging uncertain time for the travel industry. 2. Earlier in 2002, it appeared that the industry had a real momentum and was recovering at a healthy clip, but by mid 2Q02, the recovery had stopped and demand has been disappointing ever since. 3. TSG expects to see improved revenue picture for all four of its companies in 2003, but will continue to be in a demand challenged environment. 4. There is a reduced forecast for airline capacity in 2003 in spite of GDP growth forecast in 3% range. 5. Expects top line to be a better one in 2003, especially Travelocity growing in excess of 40% vs. the disappointing low single digit growth in 2002.

S2. 4Q02 & 2002 PROJECTIONS (B.H.) 1. Low travel demand combined with a venture capital write down, deferred revenue in Latin America, and some other cats and dogs expected to be taken in 4Q02 makes it necessary to lower 4Q02 EPS estimate to a range of \$0.12-0.15 before special items vs. previous estimate of \$0.20-0.25. 2. Therefore before special items, 2002 EPS forecast will be adjusted from \$1.85-1.95 to \$1.77-1.80. 3. Expects 2002 total co. revenue growth in the range of negative 3-4%. 4. Expects EBITDA to be about \$430m. 5. Expect free cash flow to be approx. \$250m. 6. While three of TSG's four companies performed admirably on the earnings line in 2002, all four dealt with pressure on the top line throughout the year. 7. Aggressive cost management was key for the three full year wholly-owned companies coming in at an aggregate 110% of operating earnings plan for 2002. 8. On a consolidated basis, TSG will miss its original full year earnings target by 2-3%. 9. TSG entered 2002 with a strong BS and exit with an even stronger BS. 10. In TM&D, TSG's operating margins grew by several points in 2002 in GDS business while maintaining the highest customer satisfaction scores in the industry. 11. In Airline Solutions,

TSG's top line revenue grew and operating margins improved from zero to 10% in 2002. 12. In GetThere, TSG cut operating losses in half and grew revenue by approx. 100%. 13. Travelocity lead the industry in a whole host of critical areas, but 2002 was a disappointing year. 14. TSG bought in Travelocity during 2002 and quickly put right leaders in place and has allocated the investment dollars to take one of the all time great .coms to the next level.

S3. 2003 PROJECTIONS (B.H.) 1. The plan does not take into account any impacts, which may or may not come from the DOT's recently announced proposed rule making. 2. The plan does not include any assumptions around increased hostilities in the world or structural change in the airline industry in North America. 3. The impact of possible M&A activities are not included in the plan. 4. The plan does include several important assumptions from industry growth to pricing to investment levels. 5. TSG's projected 2003 EPS before special items is between \$1.78-1.88. That's approx. zero to 5% growth YoverY. 6. On a GAAP basis, EPS is expected to be \$1.54-1.64 representing mid single digit growth. 7. At TSG level, similar to 2002, earnings and free cash flow generation will be very healthy, but YoverY earnings growth will be minimal. 8. At the holding company level, 2003 is a second year of weathering the storm and aggressively managing costs. 9. It's also a year of more aggressive investment.

S4. 2003 PROJECTIONS BY SEGMENT (B.H.) 1. Travelocity: 1. Technology expenditure will be in \$60m range. 2. Will also significantly increase advertising spend in 2003. 3. Expects to see mid-to-high single digit growth in revenue for full year range of \$2.1-2.2b. 2. GDS: 1. Should generate operating earnings of approx. \$360m during 2003, but will be fairly flat from YoverY top line revenue perspective. 2. Will have operating margins shrinking to about 23% due to weak demand and increased incentive expense. 3. Will also experience technology bubble as the co. run systems in parallel during migration to lower cost mid-range base shopping system. 4. The full year earnings benefit of this migration will begin to show up in 2004. 3. Airline Solutions: 1. Should grow revenues by about 10-15% vs. about 3% in 2002 and maintain operating margins in 10% range. 4. GetThere: 1. Should grow revenues in the 25-35% range and once again cut operating losses in half. 2. Expects to have its first positive operating margin month during 2H03. 5. Travelocity: 1. Should grow revenues by more than 40%. 2. Should improve operating margins from a negative 4% to a positive 10%.

S5. UPDATE ON DOT NPRM (B.H.) 1. NPRM (Notice of Proposed Rulemaking) addresses distribution overall, but from a TSG perspective, it is most focused on the GDS portion. 2. The co. made it clear that it believe the proposal put forth by the DOT is flawed. 1. They covers a wide range of topics and includes everything from selective regulation to an attempt to grab jurisdiction. 3. DOT simply does not have jurisdiction when it comes to non-airline owned non-GDSs. 4. TSG will insist on a level playing field whether be regulated or deregulated.

S6. REVENUE OUTLOOK & KEY OPERATING METRIC ASSUMPTIONS BY SEGMENT (J.J.) 1. Travel Marketing & Distribution (TM&D): 1. Price and volume continue to be the key levers. 2. On the pricing side, Amadeus which is one of the airline owned GDSs announced a booking fee increase several weeks ago. 3. Amadeus will implement an effective rate that under TSG's analysis, appears to be approx. 4.1% globally. 4. Today, TSG is informing its airline customers of an effective average global booking fee increase of 2.9% to be implemented on 02/01/03. 5. The fee varies by region and by participation level. 6. For its hotel and rental car customers, TSG announced a blended price increase of approx. 4.8%. 1. This new pricing makes TSG's three-year DCA discount offer more attractive to carriers looking for long-term price stability. 7. Believes these options provide the right balance for the co. and its airline customers. 8. Sabre GDS continues to provide unsurpassed value for the distribution dollar. 9. On the volume side, TSG has made several assumptions based on industry and co. specific trends. 10. Full year estimate for total global bookings is down approx. 2-3% from 2002 levels and direct bookings are expected to be down 3-4% YoverY. 11. Important elements in these overall assumptions are: 1. Travel industry growth of 0%.

2. Approx. one point decline in TSG's worldwide booking share. 3. Channel shift from GDS business from traditional agency to supplier direct of four points. 12. Worldwide booking share assumption is principally due to the expectation of share loss in the US. 13. The largest factors are: 1. The carryover impacts of gains by competition in the on-line channel in 2002. 2. The loss of CUC and Cheap Tickets after the acquisition by Cendant. 14. Has included a placeholder for deals prepared to walk away from in 2003, deals that aren't economically attractive for TSG. 15. This combination price and volume assumptions results in flat-to-slight revenue growth YoverY. 2. Travelocity: 1. Expecting to show significant improvement in operating results for 2003. 1. This improvement will be the result of efforts to double merchant sales. 2. This push of merchant content will bolster the top and bottom line as the profitability of the merchant model is 3-4 times that of commissionable content. 2. Significant revenue growth will flow from the introduction of packaging capability beginning in 2002. 3. Expects higher conversion rates from a variety of factors including site changes, packaging capability, new products, and increased advertising spend. 4. In addition, the \$5 service fee per air ticket will result in \$20-30m revenue for the full year. 5. Anticipates overall YoverY revenue growth to be in excess of 40%. 3. GetThere: 1. Total transaction growth is expected to be over 35%. 2. On the corporate side of GetThere, TSG expects transaction growth from the existing base and from international expansion, direct sales, and sales through distribution partners. 3. Anticipates YoverY corporate transaction growth of over 70%. 4. On the supplier side, until mid year, TSG will continue to feel the impact of the loss in 2002 of ATA, America West, and National. 5. Therefore, supplier transactions are estimated to be down 6% YoverY. 6. GetThere is working towards increasing its revenue per transaction by offering additional products and services. 7. Overall revenue growth for GetThere is expected to be 25-35% YoverY. 4. Airline Solutions: 1. Had a very successful year and turned the business around in 2002. 2. Expects to reach both revenue and operating earnings targets for 2002. 3. Also off to a great start for 2003 as the co. recently learned that the Transportation Security Administration will be using TSG's technology to manage its newly formed federal screener workforce. 4. TSG's resource management systems technology will help ensure that airports have the appropriate number of screeners at every security checkpoint, baggage screening, and random screening at the gate. 5. Unisys has selected TSG for this project. 6. The deal is a three-year contract with expected revenue of approx. \$17m in the first year and after that there are options to extend the contract for up to four additional years. 7. All three segments of the airline solutions portfolio, the reservations business, the products and service business, and consulting will show growth in 2003. 8. Overall revenue growth for Airline Solutions is expected to be in the range of 10-15%.

S7. EXPENSES & TECHNOLOGY INVESTMENT STRATEGY (J.J.) 1. TSG has increased its revenue per employee from continuing operations by 37% since 1999. 2. Will continue to tightly manage costs in 2003. 3. YoverY 2003 expenses are projected to increase slightly faster than revenue. 4. Example includes incentive costs. 1. Including incentives paid by TM&D paid to Travelocity, average incentives per booking will grow in the high teens YoverY and will be north of a dollar per booking. 2. Unbundling agency contracts have contributed to this increase. 3. However, the progress TSG has made in unbundling also has led to YoverY reductions in communications and device support costs which in 2003 offsets half of the total increase of incentive growth. 5. Another example of cost reduction, the elimination of over 200 positions throughout TM&D business. 6. Other examples include a broad-based salary increase which the co. didn't have in 2002 and will have in 2003. 7. Health benefit costs are anticipated to increase over 10% in 2003. 8. The transition to the new air travel shopping engine will drive some redundancy in data processing costs until all customers are converted to the new platform. This conversion is a multi year process. 9. This conversion is a multi year process. 10. TSG has a keen focus on technology spend and don't believe now is the time to cut back on that investment. 11. Total technology investment is estimated to be more than \$300m in 2003, which

includes CAPEX in the range of \$90-100m. 12. Travelocity and GetThere will be the beneficiaries of 30% of that spend. 1. The ratio of dollar invested to top line revenue in these businesses vs. TM&D is over 7:1. 13. Excluding CAPEX and maintenance spend, TSG believes over 60% of its product development spend will go towards Travelocity, GetThere, shopping, and CRM enhancements.

S8. OPERATING MARGIN ASSUMPTIONS (J.J.) 1. Margin in TM&D is expected to be approx. four points lower in 2002, principally due to weak demand and increasing incentive costs, but also ongoing investments in ATSE. 2. Travelocity operating margin for the full year is expected to be greater than 10%. 3. GetThere should cut operating losses in half in 2003 and will achieve a profitable month in 3Q03. 4. Operating margin for Airline Solutions should remain in the 10% range. 5. As a whole, TSG expects over a point decline on an adjusted basis due to the weak demand environment, growth and incentive expenses at TM&D, Travelocity product investment, and advertising expense.

S9. CASH FLOW & OTHER EXPENSES (J.J.) 1. Expects cash balance at the end of 2003 to be approx. \$1.1b. 2. EBITDA is expected to be greater than \$475m, which represents YoverY growth of more than 14%. 3. Free cash flow is projected to be greater than \$250m. 4. 2003 CAPEX is projected to be in the range of \$90-100m. 1. This is higher than the 2002 guidance due to the additional capital requirements of ATSE as well as other technology investments that were discussed previously. 5. D&A including intangible assets associated with acquisitions is estimated to be \$135m. 6. D&A excluding intangible assets from acquisitions is estimated to be \$90m.

QUESTION AND ANSWER SUMMARY

Q1. Can you give us a sense why we should be so confident that you can get such a big snap back in Travelocity in 2003? How should we assume we'll see it through the year? Is it going to be very back-end loaded in 2003? (James Kissane - Bear Stearns)

A. (Bill Hannigan) It will certainly be ramping up through '03. As we talked about before, critical to growing revenues very robustly, are the merchant hotel development which is now in place, the architecture redesign, the revenue planning and management, and the biggie is dynamic packaging. We talked about it before, dynamic packaging is a 2Q initiative as far as turn up.

A. (Sam Gilliland) Couple of things to point out that relates to the year and next year, and I'll talk a little bit about the ramp up as well. If you look at it, pretty simplistically, you'll see that the two drivers for next year for us are volume and rate. If you talk first about volume, we do intend to drive more site traffic than we have this year. We've talked about our increased advertising spend for next year already. We also intend to improve our conversion rates. So, examples of that would be the improved conversion we've already seen with our new P-cubed technology, which is the new air shopping path. Through improved site usability and some of that has occurred and we've seen it already with our improved hotel path that we rolled out with merchant model hotels. We will roll out a new car-shopping path in the first part of the year towards the end of April. Then, dynamic packaging in 2Q, which again we believe will improve our conversion rates. On top of all of those things, we will improve the way we merchandise products and in particular how we merchandise our hotel products, which we think will drive more conversion of hotels. So, that's really the volume piece of it. From a rate perspective, we've already talked about the up to \$5 fee that we'll be charging on many of the airline tickets that we sell. But, we will see this ramp up over the course of the year in our merchant volumes. We talked about doubling our merchant volumes in air and hotel by the end of 2003 and we certainly plan to do just that and we've developed very detailed plans to hit that plan.

Q2. Are you seeing any other airlines looking at the US air deal with particular interest? Why is that good for Sabre? (James F. Kissane - Bear Stearns)

A. (Bill Hannigan) We are in active discussions with a couple of airlines and again, as we talked about when we rolled out the program in October, it really was an opportunity for airlines to lock in longer term pricing and

for Sabre, it was all about the offset as far as the expectation of diminished incentive growth from a macro level, but also the sustainability of the traditional travel agency channel and the profitability of the traditional travel agency channel. Certainly a travel agency channel will continue to generate significant free cash flow for the next several years, but taking out beyond that is always interesting to us as well. We also talked on our October call about the several different stakeholders in the mix.

Q3. Just in 4Q, can you talk about what your expectations are for revenue in different lines of business? (John Mathis - Goldman Sachs)

A. The question was for 2003 revenues?

Q4. No, for 2002? (John Mathis - Goldman Sachs)

A. (Jeff Jackson) When we close the quarter out in January, we'll talk about the lines business. As we talked about, it's obviously very disappointing to miss and demand is a key part of it, but also key is the venture capital write down of the deferred revenue in Latin America. Latin America is not a great situation right now. Spotty is probably a good definition of it as far as the carriers and the economy is concerned.

Q5. You had a lot of time to review the current NPRM and I'm just curious if it stays in its current state, if you've quantified, what you think the impact will be and the timing? (John Mathis - Goldman Sachs)

A. (Bill Hannigan) We don't expect that it will stay in its current state. The last time rules were proposed about 18 months later, the rules that came out of the back end were about 180 out from the rules or the proposed rules that went in the front end. I expect it's very early in this process. The DOT has certainly put on paper what they would like to see and now it's the Congress and it's the White House and other stakeholders. Certainly we're not, as far as we're concerned, and just about every other player in the industry is concerned, the process isn't off to a good start other than the fact the constituencies have been heard and the process has already been doubled out of the gate. Most aggressive, I would expect to see anything being finalized would be mid-summer and I would be surprised if that's the case.

A. Our position on this is that we will just insist on a level playing field, regulated or deregulated, the value proposition doesn't change. We in our GDS business have the most efficient and highest yielding channel that any carrier could possibly go to market with.

Q6. Should we expect any further cost reduction programs? I know you talked about stepping up on technology spending but do you have anything in the works for further cost reductions this year? (John Mathis - Goldman Sachs)

A. (Bill Hannigan) In 2003, we will continue to aggressively work costs as we have in the past and continue to migrate to e-services for the various ways that we support our customers. As far as the base line is concerned, we've reduced our force by about 370 people last week.

Q7. Could you give us a greater sense of some of the assumptions behind your bookings forecasts for 2003? Specifically, what do you expect in terms of system-wide capacity reductions? How should we think about the impact of the UAL bankruptcy? Do potential bookings there just get redistributed, or are there any other impacts to think about? (David Togut - Morgan Stanley)

A. (Jeff Jackson) As far as UAL, I would say that's the right bet. The contracts have been assumed in just the last 48 hours as far as the TSG contracts are concerned with UAL. They have been very adamant about continuing to fly through bankruptcy. At the same time, many carriers, including UAL have talked about reduced capacity and certainly we have cranked that into our model. So, as you know, in the past we've talked about GDP times 1.2 GDP forecast are running about three. Our assumption is that then you met up against what the carriers are saying about capacity. We took the number to zero. The latest and greatest we've seen on capacity is a number in the zero range, so that's why we have (Indiscernible) that so far. As far as other contributors, we talked about channel shift of around 4%, which is a like number to the past two years.

A. (Bill Hannigan) The way we build it up first of course is to look at travel industry growth, which is of course the biggest wild card. We're planning on zero. You can see data that would suggest it might shrink. You

(Larry Robinson - Glenview Capital)

A. Our expectation is that there would be a lag in it, but that it would dampen incentive growth from a macro perspective as far as less money in the system. We talked earlier not that I would necessarily buy the direct trade-off, but price increase and incentive increase, they're like numbers. Certainly, the travel agency community knows what the price is in the marketplace, what the price incentive is in the marketplace, and it fuels acquisition and retention costs in the travel agency channel. We also would expect to dampen channel shift with all fares, all data available in the traditional travel agency channel, your expectation wouldn't be necessarily 4-5 points of shift as we've seen over the last several years, but maybe a dampening of that. Each point of shift is worth \$6-9m from an earnings perspective as well. We didn't talk about the technology bubble and technology bubble expense in '03 as we migrate to the midrange systems is a pretty meaningful number in 15-20% range from a YoverY perspective, '03 over '02, and you start calling (Phonetic) that back in '04. When you're stacking up costs and you look at a company our size, certainly things like salary increases add up.

Q19. Can you just help me understand why it makes sense to spend 1,300 bps of price in order to recapture 200 bps of volume? How does that trade make any sense? (Larry Robinson - Glenview Capital)

A. It's all about the sustainability of the model, the expectation of what does and doesn't happen incentives in concert with several other initiatives already underway. It also goes to a recognition of the DOT getting very involved in distribution in our industry and creating a platform that allows us to increase price when at the same time putting it off on the marketplace it allows the airlines to get what they've been asking for, which is price stability.

Q20. You're going to end up with a \$1.1b in cash at the end of next year and \$700m in cash net of debt. I know you've talked about strategic acquisitions, but the business even in a year as difficult as '02 generated \$250m of free cash flow. There aren't any conceivable set of circumstances that see out there that would have you being cash users in any particular period other than for things such as acquisitions. Why doesn't share repurchase or meaningful dividend make sense relative to \$18 stock price when it made sense with \$24 stock price? (Larry Robinson - Glenview Capital)

A. You're right. \$250m is also the number for free cash flow for '03. I expect that you're right as well that we are not a user of cash except for M&A and we will continue to keep an eye on the stock buyback side. At the same time the only variable you didn't mention was the rainy day fund based on what's going on in the world in the industry right now.

Q21. Can you tell us exactly what type of bookings on Travelocity are going to generate this \$5 fee? What portion of total bookings those would have been in '02 that would have generated a \$5 fee? (Jennifer Bergen - Merrill Lynch)

A. Our expectation is that the incremental \$5 fee will be on non-package non-merchant tickets.

Q22. That's the majority in '02. What portion bookings should that be in '03? (Jennifer Bergen - Merrill Lynch)

A. The majority.

Q23. It seems like you are implementing the \$5 service fee. Is that being pretty much completely offset by increased advertising for Travelocity? It seems like that should be much more additive to 2003's margins and earnings than it's going to be. (Jennifer Bergen - Merrill Lynch)

A. I wouldn't give you that number because I don't want to give you the add budget number because that's pretty strategic.

A. We have made an assumption for some small volume decline in our plan based on putting the fee out there. So, we're not going to disclose what that is, but we've made an assumption for some volume declines based on implementing the fee in the process.

Q24. What do you mean by volume declines? (Jennifer Bergen - Merrill Lynch)

A. (Sam Gilliland) I think because the on-line channel is a price sensitive channel, we expect there could be some shift to alternatives. It's not

dramatic, but certainly we've not modeled it that way, but it's something that we wanted to include in our plan for 2003.

A. (Jeff Jackson) Especially price sensitive on a published component basis.

Q25. On the loss of market share, I guess both toward GDS and to Direct Connect, on the Direct Connect, are you already seeing an effect? If so, how are you modeling that 4%? On the market share, is there a particular GDS that's taking share from you or is this just a general comment? (Ahmet Meta - Crestwood Capital)

A. (Bill Hannigan) As far as 2002 is concerned, the share loss was almost purely accounted for by Orbitz using Worldspan and by Cendant acquiring a couple of customers, CUC and Cheap Tickets, and our expectation of those bookings moving to Cendant's Galileo systems as you would expect period.

A. (Jeff Jackson) We gained share in the brick and mortar channel in 2002.

A. (Bill Hannigan) We haven't seen anything meaningful on Direct Connect side, but the four points of shift accounts for anything that would fall into that category.

Q26. On Travelocity, obviously you're projecting a pretty good growth for 2003. How much of that is just overall industry growth and how much of that do you see maybe taking share away from some of the other big players? Are you going to provide any indication of a break out between merchant and airfare so we can sort of evaluate you vs. the other guys? (Ahmet Meta - Crestwood Capital)

A. (Sam Gilliland) We do expect growth in the on-line channel in 2003, but we also expect to take share. That's built into our plans. As it relates to the merchant element of the business, we do plan to provide you with more detail in the future about how that breaks out.

A. We have broken that out in the past. It will just be a bigger number going through '03 on the merchant side.

Q27. What's the difference in the price increase, if any, will be between your basic level of service and the premiere level of service for the GDS? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) I think we're at 3.1-3.2 on the BCA level which is the highest level of connectivity.

Q28. What about just the basic level? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) 4%.

Q29. What's going to be the approximate size of the VC write down in 4Q? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) 3.5-5.

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CC: "Trey Nicoud" <trey.nicoud@aa.com>

EXHIBIT 5

year 2000, and because of the dot com there was tremendous demand for those types of people, and their salaries escalated well in excess of five percent a year. As well, I think we've had a little bit of discussion in this courtroom -- heard a little discussion about incentives.

When we compete for business to get travel agencies to use the Sabre GDS, one way we compete, in addition to our technology, is on price. We actually share back a portion of the booking fee with the travel agencies, and it's something that we call incentives. Our incentives in the United States have increased at an average annual rate over the past five years of 30 percent, well in excess of the booking fee increase that we pass along to the carriers, and we've been able to keep -- and that incentives are our single largest line of expense and accelerating at a rapid rate. We've been able to hold the booking fee increase down that we pass along to the carriers because we've been very aggressive on the cost side in pulling costs out of our business.

Q Have you actually reduced management and operations people in your area to help to try to keep costs down?

A In my organization since 1999, we've reduced our head count by 44 percent, from 810 people to 450

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people as we've re-engineered the way we serve our customers, and, again, in an effort to keep focus on our costs so we don't have to raise booking fees as much to the carriers.

Q Did there come a time when airlines reduced and

volatile.

Q And that means it changes sometimes on a daily basis?

A Yes.

Q Web fares are very important to the traveling public, aren't they?

A As I've said before, travelers always want to get the best fare.

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Q I think the way you've said it before, which I though was very pithy, was everybody likes low prices.

A Sure.

Q And the fact is that web fares are often the lowest priced way to take an airline trip, aren't they?

A Often times they are.

Q It would hurt the traveling public if web fares went away, wouldn't it?

A Not necessarily.

Q From Sabre's perspective it wouldn't necessarily be so bad if there weren't any web fares in the world, isn't that right?

A That's right.

Q Now, Sabre has a web site, doesn't it?

A Yes, we do.

Q It has some very sophisticated computer systems, doesn't it?

A Yes, we do.

Q Sabre protects its computer systems and its data on its computer systems.

A Yes.

doesn't plan to use the AA.com data retriever, does it?

A In other intentional markets, that's correct.

Q All right. And Sabre will pay the full license fee to FareChase, even though it's not using the AA.com data retriever in any intentional market other than Canada, right?

A I don't know.

Q You're not sure whether Sabre's going to pay the license fee?

A You seemed to imply that there would be a change. We're obviously going to pay whatever we've contractually agreed to pay.

Q Now, there are other data retrievers that Sabre is not using with this FareChase product, isn't there?

A I don't know.

Q Sabre is not using the data retriever for Southwest Airlines' web site, is it?

A I'm not sure.

Q Well, in your deposition you told me that at some point a decision was made -- a corporate decision was made at Sabre not to scrape AA -- excuse me, Southwest airlines' web site.

A That was my understanding. Again, I don't have a hundred percent certainty of knowledge that that's the

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case.

Q Now, Southwest is one of the successfully competing airlines right now out in the market, isn't it?

A Yes.

MR. WALLACE: Judge, I'm going to object on relevancy grounds as to what they are or are not doing with Southwest Airlines. I don't see what that has to do with this hearing.

MR. YETTER: Part of this hearing, Your Honor, was FareChase and Sabre's argument that if they couldn't use the AA.com data retriever, it would totally disrupt all their plans and they would be impacted and hurt. The fact that they are not using another very significant airline to search their -- that airlines's web site, Southwest.Com, is directly responsive to the point that they have brought up in this hearing.

THE COURT: All right. Overruled. I agree. Let's go ahead, if she knows the answer.

A I'm sorry. Can you question the question

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0 again?

MR. YETTER: Ms. Court Reporter, could you read back that last question for us?

I remember what is is.

THE COURT REPORTER: Okay.

Q (BY MR. YETTER) It was actually a lead-up question, Ms. Keszler. Southwest has been successfully competing in the travel business lately, hasn't it?

A Yes. I think I said yes to that question.

Q And it has been doing that for sometime, hasn't it?

A Yes.

Q Southwest is one of those low cost carriers out there, isn't it?

A Yes.

Q And it always one of those low fair carriers; in other words, their prices are low?

A They're a low cost carrier and they have low fares.

Q They don't participate in every GDS, does it?

A That's right. They participate in Sabre.

Q Sabre's the only GDS that Southwest perhaps in, isn't it?

A That's correct.

Q Sabre is a very important client to Sabre,

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isn't it?

A Southwest is a very important client to Sabre?

Q Southwest is a very important client to Sabre, isn't it?

A All of our customers are important to us. Southwest is certainly important to us.

Q And Southwest -- if Sabre got Southwest upset, Southwest might pull its business from Sabre, couldn't it?

A They could.

Q Southwest doesn't participate to the same extent that American Airlines participates in the Sabre system, does it?

THE COURT: You have to rephrase. You meant Southwest

MR. YETTER: I'm sorry.

Q (BY MR. YETTER) So if Southwest walked away from the GDS's entirely, that would only affect a small percentage of its ticket sales, wouldn't it?

A A smaller percentage. Again, I'm not sure that it's small. I think it's still a decent percentage of

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□ their bookings.

Q Less than 20 percent, isn't it?

A I don't know.

Q American's is more than 65 percent, isn't it?

A I believe Mr. Kreger testified to that. Again, I don't have any data on either of those.

Q Now, early on, Sabre understood that there was a risk that it would have to disable the AA.com data retriever; isn't that true?

A I don't know.

Do you have Plaintiff's Exhibit 205 in front of you.

THE COURT: Let's take a seven-minute break. She's got to change out tape and stuff. Let's do that right quick.

(Recess taken.)

THE COURT: We're back on the record. For the record, all parties and all attorneys are present.

Mr. Yetter, you were asking Ms. Keszler some questions.

MR. YETTER: Yes, Your Honor, but we might
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liability, so there's no question they're both long-term contracts.

Q Sabre likes people to sign long-term contracts with Sabre, obviously?

A Sure.

Q Sabre doesn't like travel agents to sign long-term contracts with American?

A No, I didn't say that.

Q In fact, Sabre's position in this courtroom is that it would just as soon see American's EveryFare program go away?

A I don't know that a Sabre person has said that in this this courtroom. I think I said that in my deposition.

Q Well, you are a Sabre person, Ms. Keszler, and let me ask you that directly? Would you, Ms. Keszler, as the head of the travel agents for Sabre and North America, would you as just soon see American's EveryFare program go away?

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A Yes.

Q Now, Sabre will survive if it cannot use the AA.com data retriever, isn't that right?

A Yes.

Q Sabre will even thrive if it cannot use the AA.com data retriever, isn't that right?

A I don't know, possibly.

Q Sabre is prepared to drop the AA.com data retriever if this Court so orders; isn't that true?

A I don't think we have a choice if the Court so

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DOT called GDSS?

A Yes. They related to the DOT rules in the United States.

Q And would it have been possible to simply define GDS had you wanted to as one that is defined that way by the Department of transportation?

A Yes, it could have been defined that way, but -- and we contemplated that at American Airlines when we wrote this agreement, but we decided that that -- and there is a lengthy definition in those -- in those regulations of what a CRS or a GDS is. But we chose not to use it for a variety of reasons and to use this one instead.

Q Now, what I'm going to do, I'm going to go through and read some of these this and I'm going to ask you questions as to whether -- you're familiar with Orbitz, are you not?

A Yes, I am.

Q I'm going to ask you whether or not you know whether Orbitz, the way they operate and the services that they offer would qualify -- would -- does these things under this definition of GDS.

A All right.

Q First of all, it says "GDS shall mean a global distribution system." Is -- does Orbitz operate a

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global distribution system?

A They're available anywhere on the world wide web and they operate and market in areas outside the United States as well.

Q "To the extent that it is used by non airline personnel." Is it used by none airline personnel?

A Yes, it's used by non --

Q who's it used by?

A It's used by individual travelers, in some cases by travel agents.

Q "And GDS collects, stores, processes, displays and distributes information through computer terminals." Does Orbitz do that?

A Yes, it does.

Q "Information concerning air and ground transportation, lodging and other related products and services offered by travel suppliers." Does Orbitz do that?

A Yes. It does all of those things.

Q "In which enables subscribers to reserve or otherwise confirm the use of or make inquiries or obtain information in relation to such products and services." Does Orbitz do that?

A Yes, it does all of those things.

Q "And and/or issue tickets for the acquisition

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of or use of such products." And that's an and/or. Does

EXHIBIT 6

From: "Timothy F. Hannegan" <hannegan@wexlerwalker.com>
To: "'Greg Sivinski'" <greg.sivinski@aa.com>
Date: 12/16/02 10:27AM
Subject: Sabre/Interesting Reading

Business Travel News (12.13.02) Sabre Unveils Price Hike For '03

DECEMBER 13, 2002 -- Global distribution system Sabre today said it will increase by 2.9 percent the average global booking fee for 2003, effective Feb. 1, matching Amadeus' previously announced increase, but less than the average 4.1 percent increase that Sabre executives claimed Amadeus actually would implement. Sabre's air booking fee increase will vary by region and level of supplier participation.

"The price increase recognizes the stress in the industry," said Sabre chairman and CEO Bill Hannigan during a conference call this morning. "Our price increase is lower than airline-owned Amadeus' own price increase. Our view is that their North America price increase is in the 6 percent range and ours is just above 3 percent."

Hannigan added that those carriers opting to follow US Airways into the highest level of GDS participation--Sabre's Direct Connect Availability three-year option--will have an effective price discount of 13 percent come Feb. 2, versus the 10 percent originally available. He said Sabre is in "active discussions with a couple of airlines" regarding that DCA option, first implemented by US Airways.

Sabre also announced a 2003 "blended price increase" of 4.8 percent for car and hotel customers.

The company expects improved 2003 performance for all its operations. GetThere, for example, is projected to log revenue growth of 25 percent to 35 percent year over year, with total transaction growth of 35 percent. Specifically, corporate transactions are expected to jump 70 percent through growth from existing clients, international expansion and direct sales.

Travelocity is expected to increase revenues by 40 percent after single-digit growth this year. Sabre is seeking to double merchant sales, which it said is three to four times more profitable than commissionable content.

Sabre also anticipated its Airline Solutions business will grow revenue 10 percent to 15 percent. That division will handle a new three-year contract with the Transportation Security Administration to manage the federalized screener workforce.

Meanwhile, Sabre lowered financial forecasts for the fourth quarter and full-year 2002. Full-year revenue is expected to be about \$2 billion, down 4 percent year over year. For 2003, full-year revenue is projected to rise between 4 percent and 9 percent.

"While we expect to see an improved revenue picture in each of our four businesses in 2003, all indications are that the industry will continue to be demand-challenged," said CEO Bill Hannigan, noting that Sabre anticipates total global bookings next year to decline 2 percent to 3 percent with 0 percent overall capacity growth. Hannigan added that 2003 forecasts do not take into account potential M&A activity, hostilities around the world or structural changes to the North American airline industry.

Also not factored in was the U.S. Department of Transportation's recent notice of proposed rulemaking on GDS regulations, which Hannigan termed, "flawed, from selective regulation to an attempt to grab jurisdiction. DOT

simply does not have jurisdiction when it comes to non-airline-owned GDSs."

Hannigan added that DOT's proposal is not likely to stay in its current state and the most aggressive estimate of when the new proposals will be finalized is mid-summer. "The process is not off to a good start. We will insist on a level playing field, regulated or deregulated.

Sabre executive vice president and CFO Jeff Jackson said the GDS experienced a 4 percent channel shift to airline supplier-direct channels, notably Orbitz. "We anticipate a decline of one point in our share of the GDS channel, principally driven by the impact of things that happened in 2002," Jackson added, citing Cendant's acquisition of Galileo. "We do not expect a share shift in the brick-and-mortar channel."

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Press Releases

1. FD (FAIR DISCLOSURE) WIRE (12.13.02) Event Brief of Sabre Holdings 2003 Financial Outlook Analyst Conference Call - Final

CORPORATE PARTICIPANTS

. Bill Hannigan, Chairman & CEO . Karen Fugate, VP of IR . Jeff Jackson, CFO . Sam Gilliland, President & CEO of Travelocity

OVERVIEW

4Q02 EPS estimate to be in the range of \$0.12-0.15 before special items vs. previous estimate of \$0.20-0.25. Before special items, 2002 EPS forecast will be adjusted from \$1.85-1.95 to \$1.77-1.80. Q&A Focus: Expectations, cost reduction programs, Travelocity, etc.

FINANCIAL DATA

A. Key Data From Call 1. 4Q02 EPS estimate = \$0.12-0.15 before special items. 2. 2002 EPS forecast = \$1.77-1.80 before special items. 3. Expected EBITDA = \$430m. 4. Forecast for free cash flow = \$250m. 5. Projected EPS for 2003 before special items = \$1.78-1.88. 6. On a GAAP basis, EPS for 2003 = \$1.54-1.64. 7. Projected CAPEX for 2003 = \$90-100m. 8. Expected cash balance at the end of 2003 = \$1.1b.

PRESENTATION SUMMARY

S1. BUSINESS OVERVIEW (B.H.) 1. 2002 continues to be a challenging uncertain time for the travel industry. 2. Earlier in 2002, it appeared that the industry had a real momentum and was recovering at a healthy clip, but by mid 2Q02, the recovery had stopped and demand has been disappointing ever since. 3. TSG expects to see improved revenue picture for all four of its companies in 2003, but will continue to be in a demand challenged environment. 4. There is a reduced forecast for airline capacity in 2003 in spite of GDP growth forecast in 3% range. 5. Expects top line to be a better one in 2003, especially Travelocity growing in excess of 40% vs. the disappointing low single digit growth in 2002.

S2. 4Q02 & 2002 PROJECTIONS (B.H.) 1. Low travel demand combined with a venture capital write down, deferred revenue in Latin America, and some other cats and dogs expected to be taken in 4Q02 makes it necessary to lower 4Q02 EPS estimate to a range of \$0.12-0.15 before special items vs. previous estimate of \$0.20-0.25. 2. Therefore before special items, 2002 EPS forecast will be adjusted from \$1.85-1.95 to \$1.77-1.80. 3. Expects 2002 total co. revenue growth in the range of negative 3-4%. 4. Expects EBITDA to be about \$430m. 5. Expect free cash flow to be approx. \$250m. 6. While three of TSG's four companies performed admirably on the earnings line in 2002, all four dealt with pressure on the top line throughout the year. 7. Aggressive cost management was key for the three full year wholly-owned companies coming in at an aggregate 110% of operating earnings plan for 2002. 8. On a consolidated basis, TSG will miss its original full year earnings target by 2-3%. 9. TSG entered 2002 with a strong BS and exit with an even stronger BS. 10. In TM&D, TSG's operating margins grew by several points in 2002 in GDS business while maintaining the highest customer satisfaction scores in the industry. 11. In Airline Solutions,

TSG's top line revenue grew and operating margins improved from zero to 10% in 2002. 12. In GetThere, TSG cut operating losses in half and grew revenue by approx. 100%. 13. Travelocity lead the industry in a whole host of critical areas, but 2002 was a disappointing year. 14. TSG bought in Travelocity during 2Q02 and quickly put right leaders in place and has allocated the investment dollars to take one of the all time great .coms to the next level.

S3. 2003 PROJECTIONS (B.H.) 1. The plan does not take into account any impacts, which may or may not come from the DOT's recently announced proposed rule making. 2. The plan does not include any assumptions around increased hostilities in the world or structural change in the airline industry in North America. 3. The impact of possible M&A activities are not included in the plan. 4. The plan does include several important assumptions from industry growth to pricing to investment levels. 5. TSG's projected 2003 EPS before special items is between \$1.78-1.88. That's approx. zero to 5% growth YoverY. 6. On a GAAP basis, EPS is expected to be \$1.54-1.64 representing mid single digit growth. 7. At TSG level, similar to 2002, earnings and free cash flow generation will be very healthy, but YoverY earnings growth will be minimal. 8. At the holding company level, 2003 is a second year of weathering the storm and aggressively managing costs. 9. It's also a year of more aggressive investment.

S4. 2003 PROJECTIONS BY SEGMENT (B.H.) 1. Travelocity: 1. Technology expenditure will be in \$60m range. 2. Will also significantly increase advertising spend in 2003. 3. Expects to see mid-to-high single digit growth in revenue for full year range of \$2.1-2.2b. 2. GDS: 1. Should generate operating earnings of approx. \$360m during 2003, but will be fairly flat from YoverY top line revenue perspective. 2. Will have operating margins shrinking to about 23% due to weak demand and increased incentive expense. 3. Will also experience technology bubble as the co. run systems in parallel during migration to lower cost mid-range base shopping system. 4. The full year earnings benefit of this migration will begin to show up in 2004. 3. Airline Solutions: 1. Should grow revenues by about 10-15% vs. about 3% in 2002 and maintain operating margins in 10% range. 4. GetThere: 1. Should grow revenues in the 25-35% range and once again cut operating losses in half. 2. Expects to have its first positive operating margin month during 2H03. 5. Travelocity: 1. Should grow revenues by more than 40%. 2. Should improve operating margins from a negative 4% to a positive 10%.

S5. UPDATE ON DOT NPRM (B.H.) 1. NPRM (Notice of Proposed Rulemaking) addresses distribution overall, but from a TSG perspective, it is most focused on the GDS portion. 2. The co. made it clear that it believe the proposal put forth by the DOT is flawed. 1. They covers a wide range of topics and includes everything from selective regulation to an attempt to grab jurisdiction. 3. DOT simply does not have jurisdiction when it comes to non-airline owned non-GDSs. 4. TSG will insist on a level playing field whether be regulated or deregulated.

S6. REVENUE OUTLOOK & KEY OPERATING METRIC ASSUMPTIONS BY SEGMENT (J.J.) 1. Travel Marketing & Distribution (TM&D): 1. Price and volume continue to be the key levers. 2. On the pricing side, Amadeus which is one of the airline owned GDSs announced a booking fee increase several weeks ago. 3. Amadeus will implement an effective rate that under TSG's analysis, appears to be approx. 4.1% globally. 4. Today, TSG is informing its airline customers of an effective average global booking fee increase of 2.9% to be implemented on 02/01/03. 5. The fee varies by region and by participation level. 6. For its hotel and rental car customers, TSG announced a blended price increase of approx. 4.8%. 1. This new pricing makes TSG's three-year DCA discount offer more attractive to carriers looking for long-term price stability. 7. Believes these options provide the right balance for the co. and its airline customers. 8. Sabre GDS continues to provide unsurpassed value for the distribution dollar. 9. On the volume side, TSG has made several assumptions based on industry and co. specific trends. 10. Full year estimate for total global bookings is down approx. 2-3% from 2002 levels and direct bookings are expected to be down 3-4% YoverY. 11. Important elements in these overall assumptions are: 1. Travel industry growth of 0%.

2. Approx. one point decline in TSG's worldwide booking share. 3. Channel shift from GDS business from traditional agency to supplier direct of four points. 12. Worldwide booking share assumption is principally due to the expectation of share loss in the US. 13. The largest factors are: 1. The carryover impacts of gains by competition in the on-line channel in 2002. 2. The loss of CUC and Cheap Tickets after the acquisition by Cendant. 14. Has included a placeholder for deals prepared to walk away from in 2003, deals that aren't economically attractive for TSG. 15. This combination price and volume assumptions results in flat-to-slight revenue growth YoverY. 2. Travelocity: 1. Expecting to show significant improvement in operating results for 2003. 1. This improvement will be the result of efforts to double merchant sales. 2. This push of merchant content will bolster the top and bottom line as the profitability of the merchant model is 3-4 times that of commissionable content. 2. Significant revenue growth will flow from the introduction of packaging capability beginning in 2Q02. 3. Expects higher conversion rates from a variety of factors including site changes, packaging capability, new products, and increased advertising spend. 4. In addition, the \$5 service fee per air ticket will result in \$20-30m revenue for the full year. 5. Anticipates overall YoverY revenue growth to be in excess of 40%. 3. GetThere: 1. Total transaction growth is expected to be over 35%. 2. On the corporate side of GetThere, TSG expects transaction growth from the existing base and from international expansion, direct sales, and sales through distribution partners. 3. Anticipates YoverY corporate transaction growth of over 70%. 4. On the supplier side, until mid year, TSG will continue to feel the impact of the loss in 2002 of ATA, America West, and National. 5. Therefore, supplier transactions are estimated to be down 6% YoverY. 6. GetThere is working towards increasing its revenue per transaction by offering additional products and services. 7. Overall revenue growth for GetThere is expected to be 25-35% YoverY. 4. Airline Solutions: 1. Had a very successful year and turned the business around in 2002. 2. Expects to reach both revenue and operating earnings targets for 2002. 3. Also off to a great start for 2003 as the co. recently learned that the Transportation Security Administration will be using TSG's technology to manage its newly formed federal screener workforce. 4. TSG's resource management systems technology will help ensure that airports have the appropriate number of screeners at every security checkpoint, baggage screening, and random screening at the gate. 5. Unisys has selected TSG for this project. 6. The deal is a three-year contract with expected revenue of approx. \$17m in the first year and after that there are options to extend the contract for up to four additional years. 7. All three segments of the airline solutions portfolio, the reservations business, the products and service business, and consulting will show growth in 2003. 8. Overall revenue growth for Airline Solutions is expected to be in the range of 10-15%.

S7. EXPENSES & TECHNOLOGY INVESTMENT STRATEGY (J.J.) 1. TSG has increased its revenue per employee from continuing operations by 37% since 1999. 2. Will continue to tightly manage costs in 2003. 3. YoverY 2003 expenses are projected to increase slightly faster than revenue. 4. Example includes incentive costs. 1. Including incentives paid by TM&D paid to Travelocity, average incentives per booking will grow in the high teens YoverY and will be north of a dollar per booking. 2. Unbundling agency contracts have contributed to this increase. 3. However, the progress TSG has made in unbundling also has led to YoverY reductions in communications and device support costs which in 2003 offsets half of the total increase of incentive growth. 5. Another example of cost reduction, the elimination of over 200 positions throughout TM&D business. 6. Other examples include a broad-base salary increase which the co. didn't have in 2002 and will have in 2003. 7. Health benefit costs are anticipated to increase over 10% in 2003. 8. The transition to the new air travel shopping engine will drive some redundancy in data processing costs until all customers are converted to the new platform. This conversion is a multi year process. 9. This conversion is a multi year process. 10. TSG has a keen focus on technology spend and don't believe now is the time to cut back on that investment. 11. Total technology investment is estimated to be more than \$300m in 2003, which

includes CAPEX in the range of \$90-100m. 12. Travelocity and GetThere will be the beneficiaries of 30% of that spend. 1. The ratio of dollar invested to top line revenue in these businesses vs. TM&D is over 7:1. 13. Excluding CAPEX and maintenance spend, TSG believes over 60% of its product development spend will go towards Travelocity, GetThere, shopping, and CRM enhancements.

S8. OPERATING MARGIN ASSUMPTIONS (J.J.) 1. Margin in TM&D is expected to be approx. four points lower in 2002, principally due to weak demand and increasing incentive costs, but also ongoing investments in ATSE. 2. Travelocity operating margin for the full year is expected to be greater than 10%. 3. GetThere should cut operating losses in half in 2003 and will achieve a profitable month in 3Q03. 4. Operating margin for Airline Solutions should remain in the 10% range. 5. As a whole, TSG expects over a point decline on an adjusted basis due to the weak demand environment, growth and incentive expenses at TM&D, Travelocity product investment, and advertising expense.

S9. CASH FLOW & OTHER EXPENSES (J.J.) 1. Expects cash balance at the end of 2003 to be approx. \$1.1b. 2. EBITDA is expected to be greater than \$475m, which represents YoverY growth of more than 14%. 3. Free cash flow is projected to be greater than \$250m. 4. 2003 CAPEX is projected to be in the range of \$90-100m. 1. This is higher than the 2002 guidance due to the additional capital requirements of ATSE as well as other technology investments that were discussed previously. 5. D&A including intangible assets associated with acquisitions is estimated to be \$135m. 6. D&A excluding intangible assets from acquisitions is estimated to be \$90m.

QUESTION AND ANSWER SUMMARY

Q1. Can you give us a sense why we should be so confident that you can get such a big snap back in Travelocity in 2003? How should we assume we'll see it through the year? Is it going to be very back-end loaded in 2003? (James Kissane - Bear Stearns)

A. (Bill Hannigan) It will certainly be ramping up through '03. As we talked about before, critical to growing revenues very robustly, are the merchant hotel development which is now in place, the architecture redesign, the revenue planning and management, and the biggie is dynamic packaging. We talked about it before, dynamic packaging is a 2Q initiative as far as turn up.

A. (Sam Gilliland) Couple of things to point out that relates to the year and next year, and I'll talk a little bit about the ramp up as well. If you look at it, pretty simplistically, you'll see that the two drivers for next year for us are volume and rate. If you talk first about volume, we do intend to drive more site traffic than we have this year. We've talked about our increased advertising spend for next year already. We also intend to improve our conversion rates. So, examples of that would be the improved conversion we've already seen with our new P-cubed technology, which is the new air shopping path. Through improved site usability and some of that has occurred and we've seen it already with our improved hotel path that we rolled out with merchant model hotels. We will roll out a new car-shopping path in the first part of the year towards the end of April. Then, dynamic packaging in 2Q, which again we believe will improve our conversion rates. On top of all of those things, we will improve the way we merchandise products and in particular how we merchandise our hotel products, which we think will drive more conversion of hotels. So, that's really the volume piece of it. From a rate perspective, we've already talked about the up to \$5 fee that we'll be charging on many of the airline tickets that we sell. But, we will see this ramp up over the course of the year in our merchant volumes. We talked about doubling our merchant volumes in air and hotel by the end of 2003 and we certainly plan to do just that and we've developed very detailed plans to hit that plan.

Q2. Are you seeing any other airlines looking at the US air deal with particular interest? Why is that good for Sabre? (James F. Kissane - Bear Stearns)

A. (Bill Hannigan) We are in active discussions with a couple of airlines and again, as we talked about when we rolled out the program in October, it really was an opportunity for airlines to lock in longer term pricing and

for Sabre, it was all about the offset as far as the expectation of diminished incentive growth from a macro level, but also the sustainability of the traditional travel agency channel and the profitability of the traditional travel agency channel. Certainly a travel agency channel will continue to generate significant free cash flow for the next several years, but taking out beyond that is always interesting to us as well. We also talked on our October call about the several different stakeholders in the mix.

Q3. Just in 4Q, can you talk about what your expectations are for revenue in different lines of business? (John Mathis - Goldman Sachs)

A. The question was for 2003 revenues?

Q4. No, for 2002? (John Mathis - Goldman Sachs)

A. (Jeff Jackson) When we close the quarter out in January, we'll talk about the lines business. As we talked about, it's obviously very disappointing to miss and demand is a key part of it, but also key is the venture capital write down of the deferred revenue in Latin America. Latin America is not a great situation right now. Spotty is probably a good definition of it as far as the carriers and the economy is concerned.

Q5. You had a lot of time to review the current NPRM and I'm just curious if it stays in its current state, if you've quantified, what you think the impact will be and the timing? (John Mathis - Goldman Sachs)

A. (Bill Hannigan) We don't expect that it will stay in its current state. The last time rules were proposed about 18 months later, the rules that came out of the back end were about 180 out from the rules or the proposed rules that went in the front end. I expect it's very early in this process. The DOT has certainly put on paper what they would like to see and now it's the Congress and it's the White House and other stakeholders. Certainly we're not, as far as we're concerned, and just about every other player in the industry is concerned, the process isn't off to a good start other than the fact the constituencies have been heard and the process has already been doubled out of the gate. Most aggressive, I would expect to see anything being finalized would be mid-summer and I would be surprised if that's the case.

A. Our position on this is that we will just insist on a level playing field, regulated or deregulated, the value proposition doesn't change. We in our GDS business have the most efficient and highest yielding channel that any carrier could possibly go to market with.

Q6. Should we expect any further cost reduction programs? I know you talked about stepping up on technology spending but do you have anything in the works for further cost reductions this year? (John Mathis - Goldman Sachs)

A. (Bill Hannigan) In 2003, we will continue to aggressively work costs as we have in the past and continue to migrate to e-services for the various ways that we support our customers. As far as the base line is concerned, we've reduced our force by about 370 people last week.

Q7. Could you give us a greater sense of some of the assumptions behind your bookings forecasts for 2003? Specifically, what do you expect in terms of system-wide capacity reductions? How should we think about the impact of the UAL bankruptcy? Do potential bookings there just get redistributed, or are there any other impacts to think about? (David Togut - Morgan Stanley)

A. (Jeff Jackson) As far as UAL, I would say that's the right bet. The contracts have been assumed in just the last 48 hours as far as the TSG contracts are concerned with UAL. They have been very adamant about continuing to fly through bankruptcy. At the same time, many carriers, including UAL have talked about reduced capacity and certainly we have cranked that into our model. So, as you know, in the past we've talked about GDP times 1.2 GDP forecast are running about three. Our assumption is that then you met up against what the carriers are saying about capacity. We took the number to zero. The latest and greatest we've seen on capacity is a number in the zero range, so that's why we have (Indiscernible) that so far. As far as other contributors, we talked about channel shift of around 4%, which is a like number to the past two years.

A. (Bill Hannigan) The way we build it up first of course is to look at travel industry growth, which is of course the biggest wild card. We're planning on zero. You can see data that would suggest it might shrink. You

can see data that suggests it would grow. We hope certainly that it is better than zero but that's where we've got built in our plan. Then we go on, and we talk about the four points of shift from the channel to airline supplier direct, and then we've made an assumption of a decline of 1 point in our share of the GES channel and that is principally driven by YoverY impacts of things that happen in 2002 as well as a placeholder we have for being disciplined on pricing contracts which are in the market and expecting to lose some there. Overall, I don't think we're going to slip in the brick and mortar channel in terms of share in the US, but those are our key assumptions for 2003.

A. (Jeff Jackson) A couple of our competitors have been more optimistic in thinking about industry growth and we hope they're right.

A. (Bill Hannigan) But as we sit here right now, we're not seeing it.

Q8. Have you had any input from the airlines on the price increase? Could you just perhaps give us a thumbnail sketch of any discussions that occurred prior to the announcement? (David Togut - Morgan Stanley)

A. There were no discussions prior to the announcement. As far as this price increase, we're rolling it out as we speak. It went out this morning. Certainly the discussion with our airline customers is the fact that if their recognition of a couple things, a recognition of the stress in the industry and that our pricing increase is lower than the airline owned GDSs price increase which is Amadeus. The view is that their North America increase is in the 6% range. Our North America increase is just above 3%. More importantly, we now have an offer in the market place which has never been in the marketplace previously which is there to take, which is predictable pricing, long term and there is a long-term discount associated with that predictable pricing. So, what was a 10% discount yesterday will be a 13% discount come Feb. 2.

Q9. I know it's early, but have you seen any volume impact of implementing the \$5 fee? Then, maybe you could give us some updated thoughts on deployment including a potential for any increased repurchase activity? (Scott Barry - Credit Suisse First Boston)

A. (Sam Gilliland) We haven't implemented the \$5 fee at this point. We'll implement it in early 2003. So, we don't have any indications yet of what the impact is. Both certainly the upside, which we expect, or any shift in bookings.

A. (Bill Hannigan) As far as stock buyback is concerned, we always have an eye to stock buyback. We completed a program a couple of months ago, but as we sit here today, we think it's important to have a rainy day fund: (a) just based on our view of the volatility in the industry in the world right now; (b) the opportunity for strategic actions. We continue to be in active discussions in our industry as far as possible M&A. If you would've asked me a year ago, if we felt we would have gone through all of 2002 without more acquisitions, I would have been a bit surprised, but it's interesting how that's going out in the industry. But, we did have two meaningful acquisitions and a buyback in at Travelocity, and the acquisition of site 59, and continue to be very active in that area.

Q10. In terms of trying to get a little bit more clarity on the drop in operating margins on the core GDS business, is the drop roughly going to be about \$50m YoverY in terms of operating profitability? (Tom Underwood - Legg Mason)

A. (Jeff Jackson) That's pretty close.

Q11. Then I'm just trying to break that out. You've mentioned incentives would be two categories, the Travelocity incentives and other incentives, and then compensation increases and increased tech spending in the core GDS business. What would be the relative magnitude of each of those categories? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) Particularly at this time we're not prepared to break that out.

Q12. You said incentives were going to be north of \$1 a segment or \$1 a booking, which I guess, would mean about \$430m or so for next year. How does that compare to this year? (Tom Underwood - Legg Mason)

A. (Jeff Jackson) I don't know where you get the \$430m.

Q13. What do you assume for total booking? (Tom Underwood - Legg Mason)

A. (Jeff Jackson) Our direct bookings would be in the range of \$330m next year.

A. (Bill Hannigan) So it is a big number, yes.

Q14. North of a dollar would be \$330m, then? How does that compare to this year? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) What we said is in the call was that our growth would be in the high teens.

A. (Jeff Jackson) We've been saying previously the mid teens this year 2002 over 2001.

A. Don't forget that includes an incentive came from TM&D to Travelocity which of course is a significant component of the overall growth and the overall base.

A. This is something that's been changing over the past two years. When you think about incentive growth and Jeff talked about it, there is an offset to incentive growth that is directly linked which is the unbundling of contracts, and we have been significantly taking out costs along the way as well. So, the definition of incentive certainly has changed over the past couple of years. But, it's still a big number no matter how you measure it.

Q15. Does the line item of inner segment revenue elimination for Travelocity in your Ks and Q's represent approx. what the incentive payments would be or is there other stuff in that line item? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) It is. I think you said it correctly. There are other items in that inner segment elimination. A big part of it is incentive payment.

Q16. What do you expect for gross booking growth for Travelocity next year? (Tom Underwood - Legg Mason)

A. (Sam Gilliland) 25-35%.

Q17. Can you just help provide a little more color on the decline in operating income in the GDS segment? I think if we can summarize your guidance correctly, you have volume down 3-4%. You have pricing up three globally within any customer that chooses a US air deal, taking price down against that. We have incentives, which are, I don't know, 20% or 24% of cost rising in the high teens. Is it safe to say that the price increase is entirely offset by the incentive increase on a dollar-by-dollar basis, and therefore your volume loss is coming with 100% decremental margins? I'm just trying to figure out how a 3% volume loss combined with the price increases you're talking about results in such dramatic decline in operating income? (Larry Robinson - Glenview Capital)

A. (Jeff Jackson) Yes, I don't know that I would think about it purely as one against the other. But yes, the numbers work that way as far as what's going on from an incentive increase vs. price increase perspective. Certainly our expectation was in 2003 that we would get -- I think it was 8 months ago the FAA was saying the industry was going to be back 12% next year, now we're saying we expect it to be zero. So, the dynamic as far as what's gone on in the model from an incentive increase perspective YoverY from a channel shift perspective YoverY and a pricing perspective YoverY, all those numbers are pretty much in the range that they have been for the last several years. The difference this time around is that the demand is not back.

A. Don't lose the sight of the fact that I mentioned a number of other cost categories. There are a number of categories where we're driving costs out of the business on a YoverY basis that are related to travel agency support costs. So, again, the company continues to evolve as the model changes and takes costs out in those areas. But, on the flip side you got a salary increase, compensation expense growth in 2002 that we didn't have in 2001, you've got health care costs going up at about 10%, a number of other items that we were able to benefit from in 2002 on YoverY basis that we're not able to do so from a cost look in '03.

Q18. Can you just help us understand the trade-off? You made the case that it is 10% price decrease today and in February the US Air type deal is 13% price decrease for airlines. What is the economic offset to Sabre? How do we benefit from this because we get three-year stability? How does it drive down incentive payments in the event that airlines move to this strategy?

(Larry Robinson - Glenview Capital)

A. Our expectation is that there would be a lag in it, but that it would dampen incentive growth from a macro perspective as far as less money in the system. We talked earlier not that I would necessarily buy the direct trade-off, but price increase and incentive increase, they're like numbers. Certainly, the travel agency community knows what the price is in the marketplace, what the price incentive is in the marketplace, and it fuels acquisition and retention costs in the travel agency channel. We also would expect to dampen channel shift with all fares, all data available in the traditional travel agency channel, your expectation wouldn't be necessarily 4-5 points of shift as we've seen over the last several years, but maybe a dampening of that. Each point of shift is worth \$6-9m from an earnings perspective as well. We didn't talk about the technology bubble and technology bubble expense in '03 as we migrate to the midrange systems is a pretty meaningful number in 15-20% range from a YoverY perspective, '03 over '02, and you start calling (Phonetic) that back in '04. When you're stacking up costs and you look at a company our size, certainly things like salary increases add up.

Q19. Can you just help me understand why it makes sense to spend 1,300 bps of price in order to recapture 200 bps of volume? How does that trade make any sense? (Larry Robinson - Glenview Capital)

A. It's all about the sustainability of the model, the expectation of what does and doesn't happen incentives in concert with several other initiatives already underway. It also goes to a recognition of the DOT getting very involved in distribution in our industry and creating a platform that allows us to increase price when at the same time putting it off on the marketplace it allows the airlines to get what they've been asking for, which is price stability.

Q20. You're going to end up with a \$1.1b in cash at the end of next year and \$700m in cash net of debt. I know you've talked about strategic acquisitions, but the business even in a year as difficult as '02 generated \$250m of free cash flow. There aren't any conceivable set of circumstances that see out there that would have you being cash users in any particular period other than for things such as acquisitions. Why doesn't share repurchase or meaningful dividend make sense relative to \$18 stock price when it made sense with \$24 stock price? (Larry Robinson - Glenview Capital)

A. You're right. \$250m is also the number for free cash flow for '03. I expect that you're right as well that we are not a user of cash except for M&A and we will continue to keep an eye on the stock buyback side. At the same time the only variable you didn't mention was the rainy day fund based on what's going on in the world in the industry right now.

Q21. Can you tell us exactly what type of bookings on Travelocity are going to generate this \$5 fee? What portion of total bookings those would have been in '02 that would have generated a \$5 fee? (Jennifer Bergen - Merrill Lynch)

A. Our expectation is that the incremental \$5 fee will be on non-package non-merchant tickets.

Q22. That's the majority in '02. What portion bookings should that be in '03? (Jennifer Bergen - Merrill Lynch)

A. The majority.

Q23. It seems like you are implementing the \$5 service fee. Is that being pretty much completely offset by increased advertising for Travelocity? It seems like that should be much more additive to 2003's margins and earnings than it's going to be. (Jennifer Bergen - Merrill Lynch)

A. I wouldn't give you that number because I don't want to give you the add budget number because that's pretty strategic.

A. We have made an assumption for some small volume decline in our plan based on putting the fee out there. So, we're not going to disclose what that is, but we've made an assumption for some volume declines based on implementing the fee in the process.

Q24. What do you mean by volume declines? (Jennifer Bergen - Merrill Lynch)

A. (Sam Gilliland) I think because the on-line channel is a price sensitive channel, we expect there could be some shift to alternatives. It's not

dramatic, but certainly we've not modeled it that way, but it's something that we wanted to include in our plan for 2003.

A. (Jeff Jackson) Especially price sensitive on a published component basis.

Q25. On the loss of market share, I guess both toward GDS and to Direct Connect, on the Direct Connect, are you already seeing an effect? If so, how are you modeling that 4%? On the market share, is there a particular GDS that's taking share from you or is this just a general comment? (Ahmet Meta - Crestwood Capital)

A. (Bill Hannigan) As far as 2002 is concerned, the share loss was almost purely accounted for by Orbitz using Worldspan and by Cendant acquiring a couple of customers, CUC and Cheap Tickets, and our expectation of those bookings moving to Cendant's Galileo systems as you would expect period.

A. (Jeff Jackson) We gained share in the brick and mortar channel in 2002.

A. (Bill Hannigan) We haven't seen anything meaningful on Direct Connect side, but the four points of shift accounts for anything that would fall into that category.

Q26. On Travelocity, obviously you're projecting a pretty good growth for 2003. How much of that is just overall industry growth and how much of that do you see maybe taking share away from some of the other big players? Are you going to provide any indication of a break out between merchant and airfare so we can sort of evaluate you vs. the other guys? (Ahmet Meta - Crestwood Capital)

A. (Sam Gilliland) We do expect growth in the on-line channel in 2003, but we also expect to take share. That's built into our plans. As it relates to the merchant element of the business, we do plan to provide you with more detail in the future about how that breaks out.

A. We have broken that out in the past. It will just be a bigger number going through '03 on the merchant side.

Q27. What's the difference in the price increase, if any, will be between your basic level of service and the premiere level of service for the GDS? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) I think we're at 3.1-3.2 on the BCA level which is the highest level of connectivity.

Q28. What about just the basic level? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) 4%.

Q29. What's going to be the approximate size of the VC write down in 4Q? (Tom Underwood - Legg Mason)

A. (Bill Hannigan) 3.5-5.

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CC: "'Trey Nicoud'" <trey.nicoud@aa.com>

EXHIBIT 7

from Travel Weekly online

Amadeus plan offers contract options (2/24/2003)

By Andrew Compart

WASHINGTON -- Amadeus launched a new pricing plan for North American agents that eliminates productivity pricing for firms that forego a signing bonus in their GDS contract.

In addition, agents will be paid monthly under the plan.

Agencies that sign contracts under the ProfitChoice program will be paid per booked segment. The total automatically will be reconciled monthly by Amadeus, which will retain the amount needed to cover the agency's monthly GDS expenses.

For agencies that decided to forego a signing bonus, the rest will be returned to the agency each month as pure profit.

Kay Urban, Amadeus, North America executive vice president and chief operating officer, touted the program this way:

"The more agencies book, the more they earn. The less their expenses, the more they earn."

Amadeus tested the waters for a couple of months by showing the program to some agencies before the official unveiling and already has signed ProfitChoice contracts with a "handful" of agencies.

Amadeus said one leisure firm, which it did not name, produces 55,000 segments annually. Under productivity pricing, Amadeus said, it would be paid \$30,600 a year, or \$2,550 a month.

Under ProfitChoice, Amadeus said, it will make \$76,500 a year, or \$6,375 a month. ProfitChoice offers an agency three options.

Under the first, which provides the highest per-segment payments, the agency gets no money up front and there is no segment goal.

That's the choice taken by the agency Amadeus used in its example.

Under the second, which lowers an agency's per-segment payments somewhat, Amadeus pays a cash advance that the agency repays over time. It also has no segment goal.

Under the third, the agency receives a signing bonus, but it has a segment goal and runs the risk of penalties. The per-segment payments are the lowest of the three options.

Because accounts are reconciled monthly -- rather than by quarter or year -- the agency must meet its segment goal monthly. That means it doesn't have the rest of the quarter or year to make up for a soft month.

On the other hand, the agency doesn't run the risk of a penalty for an entire quarter or year when it can't regain the ground it lost in bad months.

ProfitChoice contracts, which range from three- to five-year terms, are being offered to new customers and renewals, but Amadeus said it is willing to talk to existing customers in mid-term.

Amadeus will continue to offer its EasyAccess product, which is targeted to smaller agencies booking fewer than 7,500 segments a year. EasyAccess offers free entry to the basic Amadeus system plus Amadeus Cruise and Consolidator Shopper, with no booking minimums. Sabre's Simplicity Plan and Galileo Select and Connect offer a similar plan for small agencies.

Travel attorney and Travel Weekly.com columnist Mark Pestronk said ProfitChoice sounds evolutionary rather than revolutionary but called it a "superb" offer that should be welcomed by agencies. He noted it also will free them to do Web bookings without creating GDS segment shortfalls and penalties.

"All four [GDS] vendors are getting easier when it comes to quotas and more generous when it comes to bonuses," Pestronk said. The reason for that may expand beyond smart business to smart politics, he added, as the Transportation Department is considering GDS rule changes that would reduce or eliminate productivity pricing.

Amadeus' Urban said the GDS began developing Profit-Choice and its other new programs well before the DOT's proposed rulemaking.

Amadeus unveiled Profit-Choice concurrently with a new program it said will help agencies lower their expenses.

Under the program, called Amadeus Workplace Solutions, Amadeus will consult with, visit and observe an agency to tailor each offer specifically for that agency, in terms of what Amadeus services and equipment it needs.

Amadeus touted it as a better option than giving an agency a choice of a few pre-packaged options.

For example, Central Travel has nine locations in northwest Ohio, but president and CEO Jani Miller told Travel Weekly.com she opted to get a ticket printer for only her corporate location because Central books more international travel there.

Central also opted to use its existing laser printers, not the Amadeus invoice printers, and to do the

Internet connection itself because it could get a better deal.

"We could determine what we needed and didn't need," said Miller, whose agency does more than \$30 million in business a year, employs 65 people and purchased 60 Amadeus workstations.

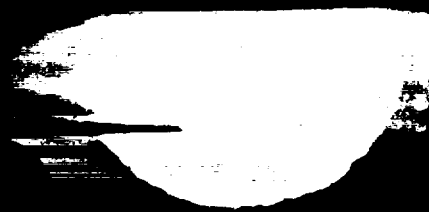
Pestronk said the concept is good but not unique. Sabre, for example, provides agencies three pages listing equipment they can choose to lease, he said.

Amadeus also unveiled an upgrade of its graphical, browser-based front-office booking system.

Vista 2.0's features include one designed to make it easy for agents to switch between the graphical user interface and the code-loaded command screens. It also includes a "Quick PNR" mode.

EXHIBIT 8

AIRLINES IN CRISIS



The Perfect Economic Storm



AIR TRANSPORT ASSOCIATION



Preface

The United States is engaged in a War on Terrorism that is soon likely to expand to hostilities in Iraq. The Air Transport Association (ATA) and its member airlines support this administration and our nation's efforts. We actively participate in the Civil Reserve Air Fleet (CRAF) program and many thousands of our employees, in particular our pilots, serve in the active reserve. We are also supportive because we have been the particular targets and unwilling instruments of terrorism, and because the deep economic morass in which we are mired is a direct result of the attacks of 9/11 and the resulting downturn in the economy.

Nevertheless, we are also mindful of the painful economic lessons of the first Gulf War and expect the economic consequences of a second Iraq experience will be even more dramatic in terms of the impact on our industry.

This report reviews our current economic crisis; outlines the impact of the first Gulf War; and forecasts the economic consequences on our industry of the expected Iraq invasion. The report highlights the need for decisive government action to counter a predictable crisis in the airline industry.

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Executive Summary

The U.S. airline industry is facing an economic crisis unlike any experienced before. In its simplest terms, the crisis is a result of an unprecedented decline in demand for air travel playing out against the backdrop of the industry's notoriously high fixed cost structure.

That decline in demand reflects both general conditions in the broader economy and a pronounced, post-9/11 public disinclination to travel by air. With the imminent prospect of a war with Iraq, market trends and experience with the first Gulf War indicate strongly that this economic crisis could deepen rapidly. Should that occur, there is a serious risk of chaotic industry bankruptcies and liquidations. Given the essential transportation links provided by the airlines and the significant role of aviation in the U.S. economy, this situation obviously warrants government attention and action to minimize the spread of economic damage.

The most likely war scenario estimates industry losses of \$10.7 billion

It must be noted that the current set of circumstances is fundamentally not a result of "normal" market forces. As this report documents, while the general state of the economy (i.e., normal market forces) is a component of the crisis, other non-market pressures, including public mood, the threat of terrorism and the prospect of war appear to be far greater contributors.

The airline industry continues to undertake massive self-help measures to try to reduce losses and stabilize itself. These measures have seen 100,000 jobs cut, schedules modified, thousands of flights eliminated, offices and facilities closed, several hundred aircraft retired or placed in storage, more than \$10 billion in reduced capital and operating budgets—and the cutting goes on. Negotiations are underway to reduce employment expenses throughout the industry by an additional \$10 billion. No possible area for savings is being overlooked.

To encourage travelers back into the air, the airlines have been forced to reduce airfares aggressively. They have done so because, despite the major capacity cuts (fewer aircraft making fewer flights), the demand for air travel remains out of sync with supply. As a consequence, airlines have no ability to pass costs through to the traveler and no pricing power. The result is airfares today that are lower than they were in 1988 in nominal, not inflation-adjusted, dollars.

In a "normal" market, this type of cost-cutting could be expected to restore profitability. That has not occurred. Instead, what has happened is that new, additional costs (or reduced revenues) have grown to adversely impact the industry's bottom line. In general, these costs have arisen from government policy decisions in the post-9/11 environment. These decisions have unquestionably enhanced security, but not without economic consequences. The report calculates that these costs are on the order of \$4 billion. Other government decisions relating to taxes and fees are playing out as well. The fact is that the industry is now carrying a tax burden that is 76 percent higher than it was in 1992, and 240 percent higher than in 1972—contributing substantially to the economic crisis.

Making matters worse, the cost of fuel has risen dramatically (from 57 cents in February 2002 to \$1.20 last month) as a result of both the threat of war and other forces. Because fuel constitutes between 10 and 15 percent of the industry's cost structure, airlines do everything

in their power to manage this cost, including the use of hedging strategies. Nevertheless, with prices rising, and every one-penny increase in the cost of a gallon of fuel costing the industry \$180 million annually, the picture is bleak.

To continue providing service, the airlines have been forced to assume a massive amount of debt, now in the range of \$100 billion. (For comparison purposes, as of February 2003, all of the outstanding stock of the network airlines had a combined value of only \$3.2 billion.) At this point, however, the industry's ability to borrow is virtually gone. A significant worsening of the economic picture will force carrier bankruptcies and possible liquidations. The prospect of a forced nationalization of the industry is not unrealistic.

To assist decision-makers in establishing policies to minimize economic harm, this report provides an assessment of the current economic state of the airline industry in the context of the expected opening of hostilities with Iraq. It does so utilizing four scenarios that incorporate current industry advance booking information, first-quarter 2003 operating data and actual experience with the first Gulf War.

A worse-
case
scenario
estimates
losses to
reach
\$13 billion

These scenarios are conservative in their estimates but present cause for concern. Under the "most likely" scenario, industry losses would be \$4 billion higher than under the base "no war" case, for total 2003 losses of \$10.7 billion. This analysis projects a 15 percent traffic decline during one quarter of "active" war activity. Again, this is based on actual carrier advance booking information, which declined internationally by more than 20 percent following the recent Code Orange security alert. A worse-case scenario is also presented, applying the Gulf War experience combined with the effects of a terrorist incident of major significance. In this scenario, industry losses would hit \$13 billion.

The airlines are not seeking government action that would interfere with normal forces in the marketplace. Rather, prudent measures are sought to mitigate the damage that is being done by the extraordinary "non-market" impact of terrorism and the prospect of war. Particularly given the pivotal role that the airline industry plays in the functioning of the entire national economy, the case for action is compelling. Conservatively estimated, absent decisive government action to mitigate the war's impact, airlines will be forced to cut at least 70,000 more jobs and eliminate 2,200 flights, hitting particularly small and mid-size communities. As the impact of those cuts plays out across the economy, hundreds of thousands of additional jobs will be lost.

The time for decisive government action to maintain this essential key to our economic success is now.

Section I

Background: Gulf War Repercussions

The U.S. airline industry always has been affected by changes in the national economy, more so since the industry's economic deregulation in 1978. This sensitivity exists because discretionary travel is one of the first expenses cut by businesses and individuals during a recession. Such declines in business hit airlines hard because they have high fixed costs that cannot be quickly or easily reduced. The two primary fixed costs are labor and aircraft. Labor costs only can be reduced through layoffs or agreements with unions, and equipment costs are fixed and expensive (a typical wide-body aircraft costs more than \$100 million). Lease payments continue regardless of whether the aircraft is in service. Fuel prices can rise sharply during international crises. When crude oil prices increase, carriers cannot simply cut service to reduce this cost. Labor and fuel alone account for more than 50 percent of all airline costs.

Labor and fuel alone account for more than 50 percent of all airline costs

This economic sensitivity was apparent immediately prior to and during the 1991 Gulf War, after which the U.S. economy slipped into recession. The state of the economy already was adversely affecting the airline industry, but the addition of specific war-related factors dramatically exacerbated conditions. A drop in passenger traffic and a doubling of fuel costs led to four years of losses totaling \$13.1 billion. While an argument can be made that, in the later years, some of these losses were the result of a weak economy, the losses of 1990 and 1991 are directly attributable to the Gulf War and its impact on commercial aviation.

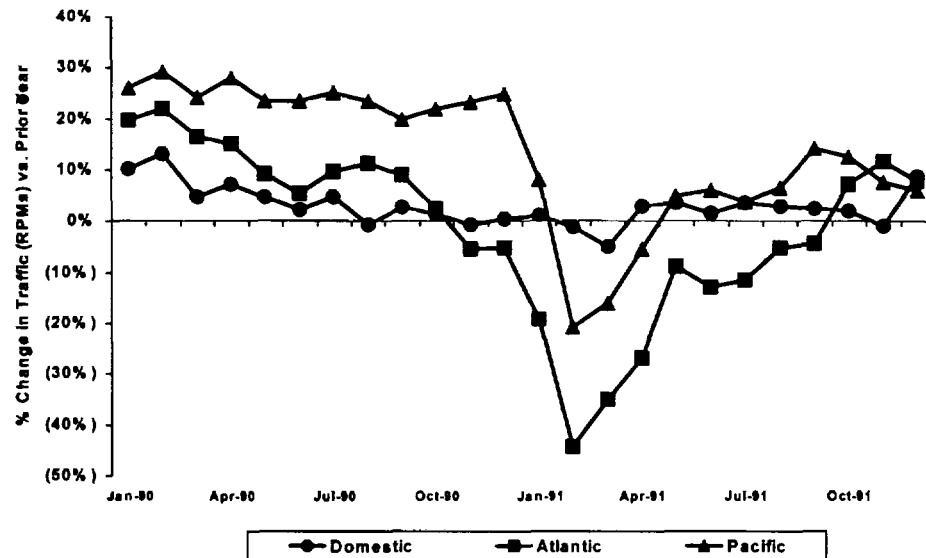
Industry operating losses were \$1.9 billion in 1990, \$1.8 billion in 1991 and \$2.4 billion in 1992. Although these losses pale in comparison to those incurred by the industry after September 11, 2001, they were at that time record-breaking. The war itself lasted only 43 days, but its direct economic repercussions were felt for a full two years by the airline industry, with full recovery taking four years. The industry did not post a full-year operating profit until 1993 and a full-year net profit until 1995.

Prior to the Gulf War, most carriers were comparatively strong, both structurally and financially. Most were recording modest profits. Overall, in 1989, the U.S. airline industry recorded \$1.8 billion in operating profits. Between 1984 and 1989, the industry had net profits of \$3.9 billion on \$12.6 billion in operating earnings. Airlines also had adequate cash reserves and access to capital markets, which today they do not enjoy.

Traffic over the Pacific grew significantly at annual rates in excess of 20 percent in the months preceding the Gulf War. Over the Atlantic, traffic increased steadily throughout the first three quarters of 1990. But in the months leading up to the Gulf War, passenger loads declined dramatically over these and other routes. Traffic over the Pacific plummeted from a growth rate of more than 20 percent to a rate of minus 21 percent. Over the Atlantic, traffic went from growing 20 percent to minus 44 percent. The impact on domestic traffic was significant but less severe, falling off 8 percent. Clearly, the American public was concerned about possible threats abroad but felt more secure domestically. The events of 9/11 have drastically altered this sense of security, leaving domestic travel more vulnerable than ever.

Chart 1

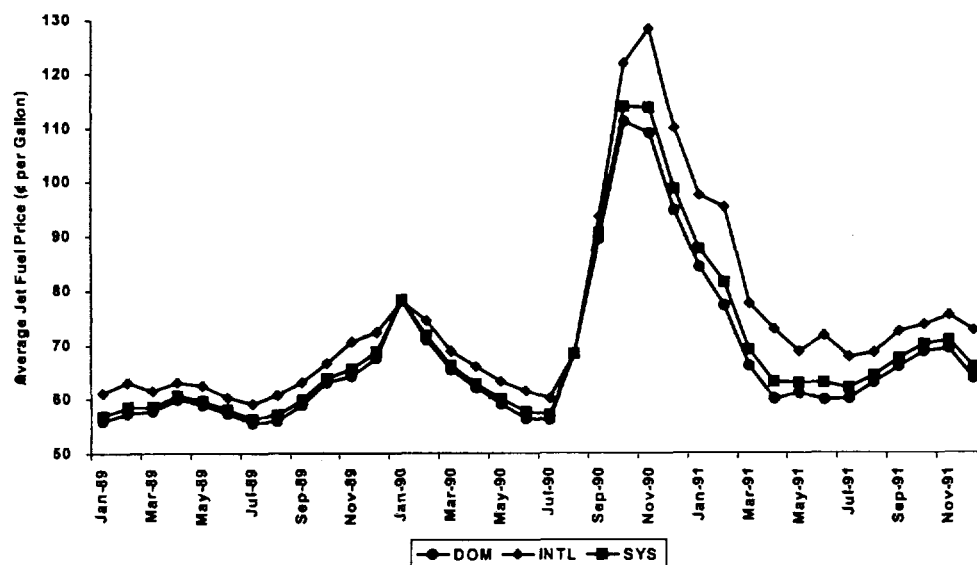
Passenger Traffic: 1990-91



Prior to Iraq's invasion of Kuwait on August 2, 1990, jet fuel prices throughout 1989 and 1990 were stable. In 1989, jet fuel cost an average of 60 cents per gallon and in July 1990 it was at 57 cents. In September 1990 prices soared to 91 cents and by October they reached \$1.14 per gallon. At that time, each one-cent rise in jet fuel prices cost the U.S. airline industry \$160 million annually.

Chart 2

Jet Fuel Price: 1989-91



Overall, the impact of the Gulf War on U.S. commercial aviation was as follows:

Traffic	- Down 8 percent systemwide, 15 percent internationally
Daily flights	- Cut by 350, reducing service to hundreds of communities
Employment	- 25,000 total lost jobs
Fuel costs	- Up 45 percent for increased costs of \$1.5 billion
Net losses	- \$13.1 billion over four years
Bankruptcies	- Seven carriers filed for bankruptcy, four liquidated

After the Gulf War, the industry shrank significantly, tens of thousands of employees lost their jobs, communities lost service and the overall U.S. economy suffered

After the Gulf War, the industry shrank significantly, tens of thousands of employees lost their jobs, communities lost service and the overall U.S. economy suffered. Although the majority of carriers were financially healthy prior to the Gulf War, several were in a weakened state. Pan Am was struggling from declining passenger traffic following the 1988 terrorist attack on Flight 103, and Eastern Airlines was experiencing protracted labor troubles. For these carriers, the rising costs and declining traffic were insurmountable obstacles, ultimately leading to the demise of these long-established corporations.

Table A

Significant Gulf War Airline Bankruptcies

	<u>Date</u>	<u>Action</u>	<u>Outcome</u>
Continental	12/3/90	Chapter 11	Emerged 4/27/93
Pan Am	1/8/91	Chapter 11	Liquidation
Eastern	1/18/91	Last Flight	Liquidation
Midway	3/25/91	Chapter 11	Liquidation
America West	6/27/91	Chapter 11	Emerged 8/25/94
TWA	1/31/92	Chapter 11	Emerged 11/3/93
Markair	6/8/92	Chapter 11	Liquidation

In fact, by 1993, the state of the industry was so threatened that President Clinton established the *National Commission to Ensure a Strong and Competitive Airline Industry* to explore ways in which the industry could be restored.

Section II

U.S. Airline Industry: 1995 to Present

The effects
of the 9/11
attacks
continue to
harm the
industry
significantly
to this day

By the spring of 2001, the U.S. airline industry was clearly entering a period of economic turbulence. The slowing economy and the bursting dot-com bubble suggested substantially slowed economic growth. Passenger traffic was expected to increase only 1 percent in 2001 from the 2000 record level of 1.8 million passengers per day (1.6 domestic; 0.2 international). Aircraft operations, which totaled 25,200 departures per day in 2000, were expected to increase only slightly in 2001. Net losses for the industry were forecast at \$3.5 billion.

Despite this daunting challenge, the airlines were positioned to weather the storm. The profitable period from 1995 to 2000 had enabled the carriers to rebuild their balance sheets from the Gulf War years. Industry cash reserves totaled some \$11 billion at the end of the first quarter of 2001 and, despite the preceding period of record demand, industry expansion had been moderate, with operating revenues growing at an annual rate of 6.6 percent from 1995 to 2000.

Table B

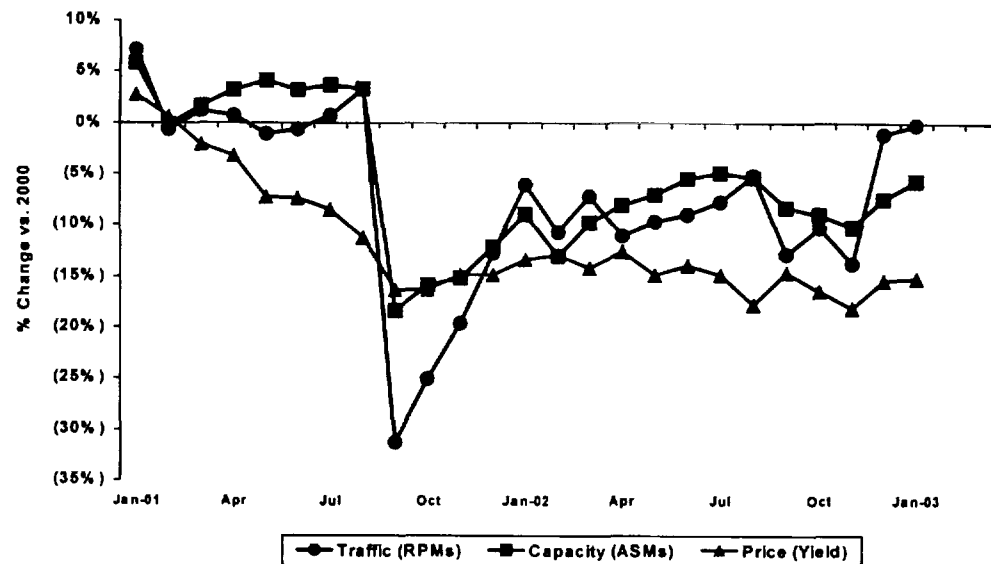
State of the U.S. Airline Industry on September 11, 2001

Cash Reserves	\$11 billion
Cash Burn Rate (assuming \$3.5 billion loss)	\$10 million per day
Net Debt-to-Capital	70-75%
Fleet	4,950 aircraft
Employment	686,000 FTEs
Projected 2001 Net Loss	\$3-3.5 billion
Major carriers in bankruptcy	0
Major carriers with investment-grade credit ratings	3

This situation changed dramatically after the September 11, 2001, terrorist attacks. The manageable economic challenge that had been confronting the airlines suddenly ran well beyond the normal range of business control and natural market forces. The effects of the 9/11 attacks continue to harm the industry significantly to this day.

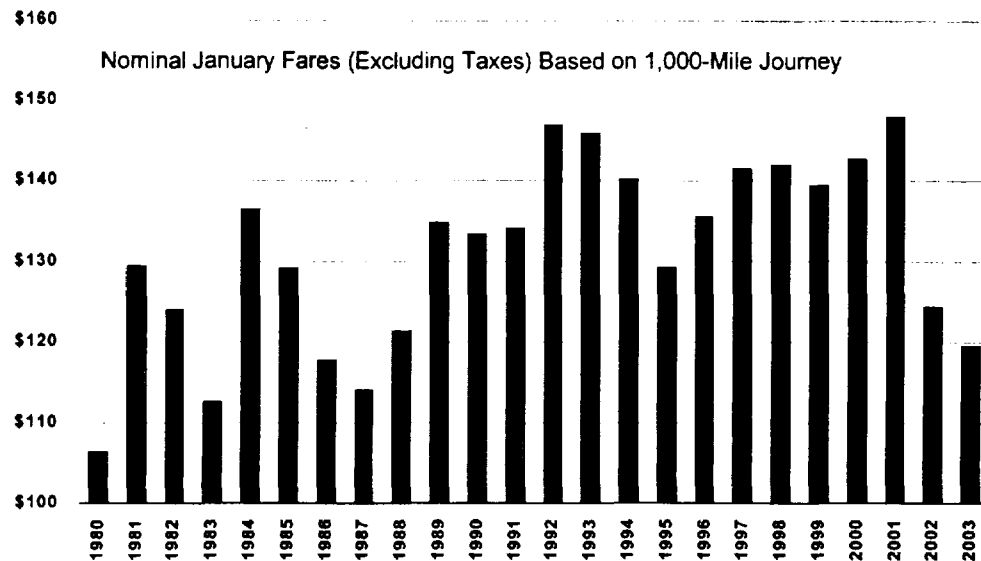
The immediate shutdown of our nation's aviation system produced a cash "burn rate" for the industry in excess of \$330 million per day for the duration of the stoppage. Once air service was restored, the combined effects of public apprehension and avoidance of air travel, for a variety of reasons, were reflected in an unprecedented drop in demand. As the following chart demonstrates, the precipitous drop in traffic following the 9/11 attacks was mirrored by the industry's sharp reduction in capacity.

Chart 3

Passenger Traffic, Capacity and Yield Trends

Despite these capacity reductions, continuing soft demand over the past 18 months has compelled airlines to price their services at record low levels to induce travelers back into the air. The results are projected industry losses of roughly \$25 billion from 2001 through 2003.

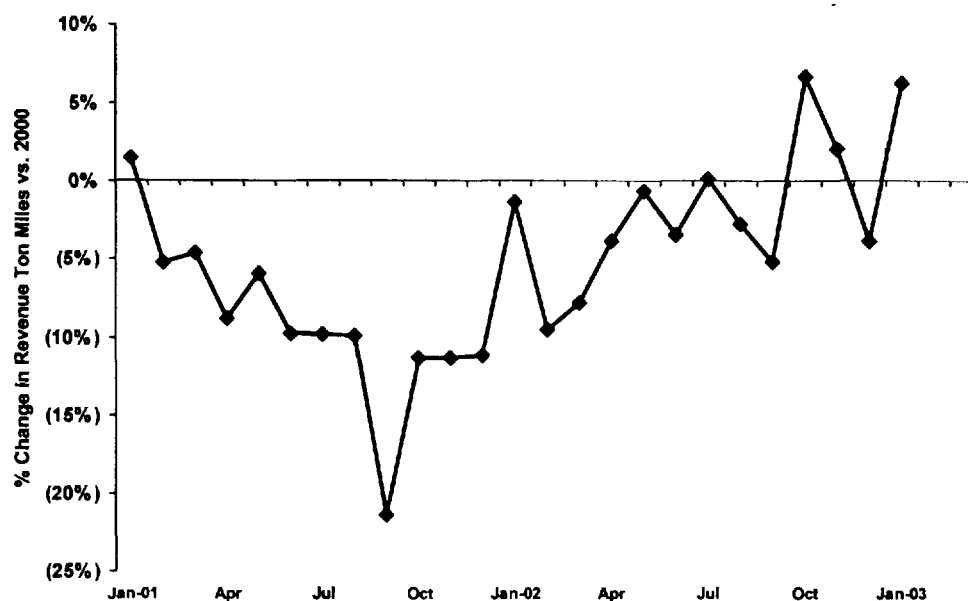
Chart 4

Nominal Airfares at Lowest Level Since 1987

The question is often asked: How can any distinction be drawn between the “normal” economic downturn in the economy that was impacting the airlines prior to 9/11, and the direct effects of the attacks? It is instructive to look at the air cargo experience for some answers.

Chart 5

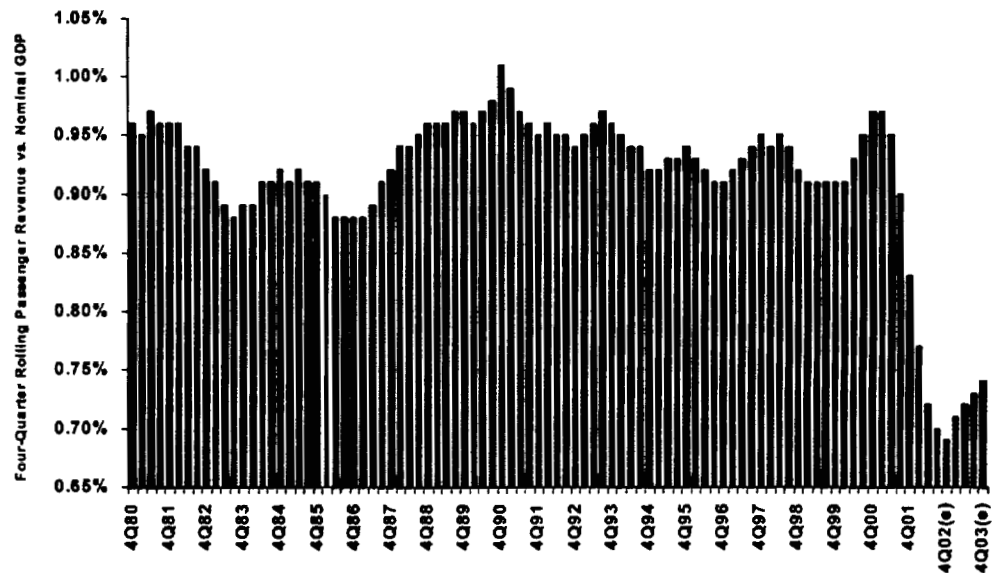
Air Freight Volume Trends



The initial 9/11 cargo declines were steep but have not persisted, as has faltering passenger demand. A case can be made that the cargo market generally reflects the impact of the broader economic slowdown and recovery cycle on the aviation market. On the other hand, passenger apprehension and avoidance factors have persisted, and it is the difference between the performance of these markets that is an area of concern—the area beyond normal business fluctuation and normal market conditions.

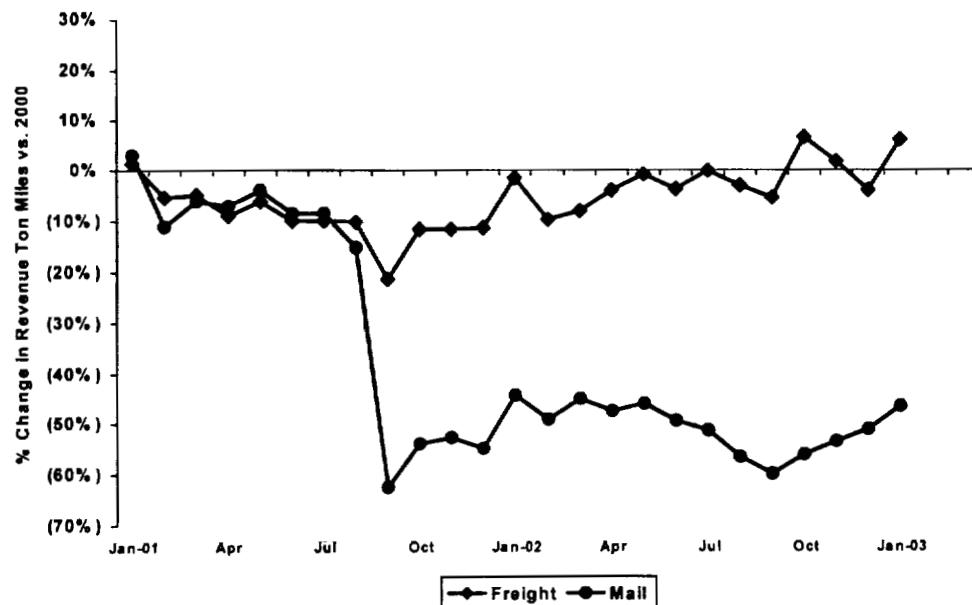
Another indicator of the abnormal change that is impacting the airlines is the growing disparity between passenger revenues and gross domestic product (GDP). Historically a consistent 0.90 to 0.95 percent of GDP, passenger revenue since 9/11 has fallen below 0.75 percent of the nation's output, suggesting that much more than conventional economic factors are at play. Again, the point is that we are confronted by economic forces that appear well beyond those of the normal business cycle.

Chart 6

Passenger Revenue vs. Nominal GDP

The chart below highlights the post-9/11 difference between freight and mail volumes. Because of security issues associated with both freight and mail, the decline of mail and modest growth of freight have been problematic for the combination carriers. Freight and mail losses are estimated at about \$400 million because of heightened security measures.

Chart 7

Air Freight and Mail Volume Trends

The Industry Responds

The airline industry has responded to the crisis by taking aggressive self-help actions necessary to stem the effect of deepening losses. As noted above, the primary tool the industry has used is to match capacity more closely with customer demand by decreasing operations, cutting staff and reducing service. While measured clinically in terms of available seat miles (ASMs) or numbers of aircraft, these cutbacks also have a sharply personal component. Nearly 100,000 employees have lost their jobs as a result of this forced contraction of the airline industry, along with nearly 400,000 others in the U.S. travel and tourism sector.

The table below provides a detailed breakdown of the Air Transport Association member airlines¹ fleet between December 31, 2000, and December 31, 2002. Moving into the period, the increase of the fleet by 69 units, as of June 30, 2001, reflects the last wave of modest capacity growth the industry experienced during the robust 1990s.

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Table C

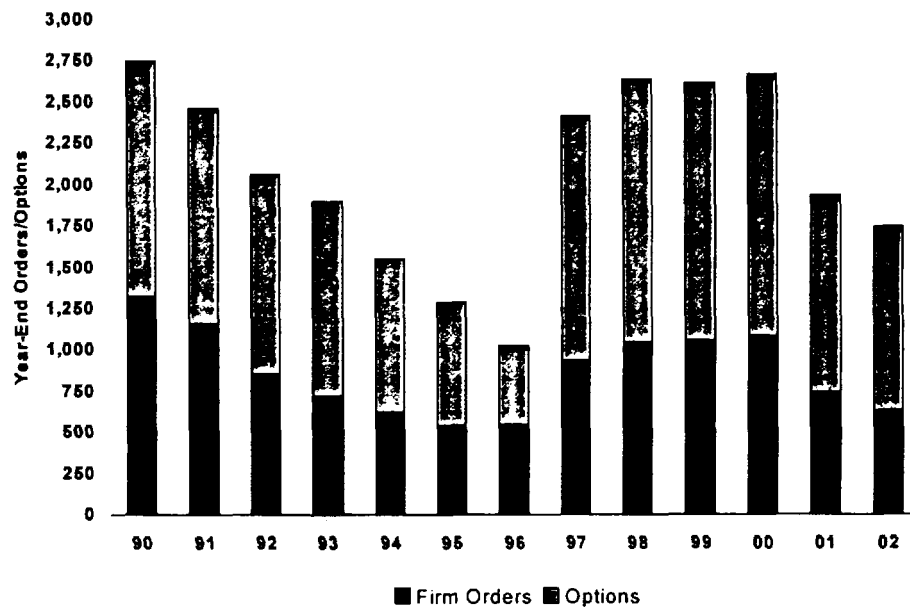
Net Change in Mainline Operating Fleet – ATA U.S. Members ¹

Fleet	6/30/01	12/31/01	6/30/02	12/31/02	Change
B727	480	333	259	224	(256)
MD80	631	573	561	554	(77)
DC10	133	111	96	72	(61)
DC9	311	274	272	268	(43)
DC8	118	80	78	77	(41)
F100	114	96	74	74	(40)
B717	28	43	13	13	(15)
L1011	20	15	13	13	(7)
B747	174	174	170	168	(6)
B737	1,296	1,277	1,303	1,294	(2)
A330	9	9	9	9	—
MD90	16	16	16	16	—
A310	41	43	46	45	4
A321	19	23	28	28	9
MD10	12	12	16	22	10
MD11	51	53	56	62	11
A300	89	94	101	104	15
B777	110	119	129	129	19
B767	333	344	359	363	30
B757	579	600	615	623	44
A319	158	177	196	210	52
A320	228	251	267	284	56
TOTAL	4,950	4,717	4,677	4,652	(298)

Sizeable reductions began with the September 11, 2001, attacks and continue to the present, prompting the fleet to shrink by 298 aircraft, with a strong emphasis on the least efficient aircraft. While several hundred new aircraft have been delivered (reflecting primarily firm, non-cancelable aircraft orders in place prior to September 11, 2001), the rate of new orders has plummeted, creating still more uncertainty for the aviation sector.

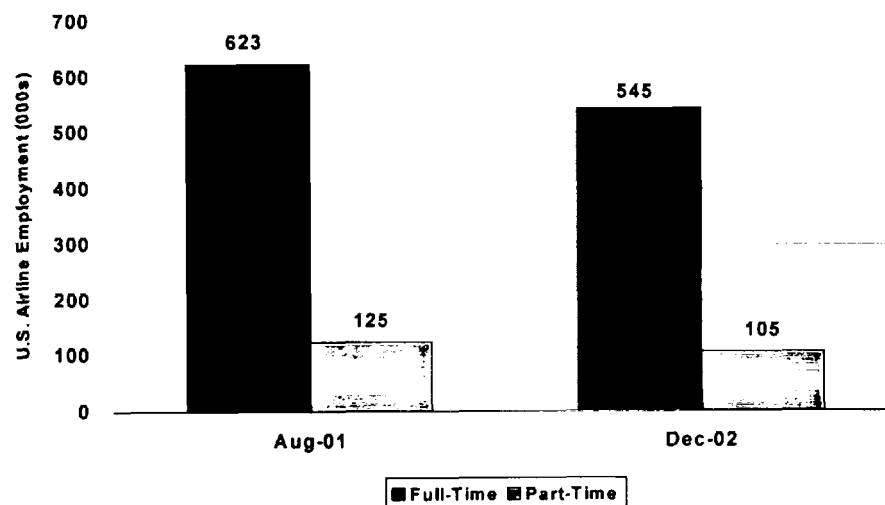
¹ ATA members are Airborne Express, Alaska Airlines, Aloha Airlines, America West Airlines, American Airlines, American Trans Air, Atlas Air, Continental Airlines, Delta Air Lines, DHL Airways, Emery Worldwide, Evergreen International, FedEx, Hawaiian Airlines, JetBlue Airways, Midwest Airlines, Northwest Airlines, Polar Air Cargo, Southwest Airlines, United Airlines, UPS Airlines and US Airways.

Chart 8

Aircraft Orders and Options Backlog – ATA U.S. Members

Aircraft utilization also has fallen. Many aircraft now operate four flights per day instead of five. As a result of aircraft retirements and reduced utilization, operations dropped from the expected 25,200 per day in 2000 to 24,400 per day in 2001, and an estimated 23,100 per day in 2002. The following chart documents the 13 percent decline in industry employment from August 2001 through December 2002, as reflected in Department of Transportation data for the entire airline industry. A total of 78,000 permanent full-time employees and 20,000 part-time workers have been cut to help save these companies and their remaining employees.

Chart 9

U.S. Airline Employment

Many other self-help measures also are being taken. The table below reflects the actions taken by the six global network airlines to reduce capital and operating budgets by more than \$10 billion. Despite the cuts, however, the financial hemorrhaging continues. Airlines have reduced inflight food service, installed automated check-in kiosks, depeaked hub operations, hedged fuel costs, closed reservation centers, eliminated stations and generally reviewed all of their costs for every potential savings—and that effort continues.

Table D

Self-Help Measures Taken by the Six U.S. Global Network Airlines*
(Year Ended September 2002 vs. 2000)

Category	Reduction	Change
Operating Expenses	\$4.5 billion	(5%)
Capital Spending	\$5.6 billion	(47%)
Capacity	100.1 billion ASMs	(13%)
Mainline Fleet	240 aircraft	(7%)
Headcount	70,112 employees	(16%)
Other	Closure of numerous city ticket offices, maintenance facilities, and reservations centers; reduction in inflight services, fuel consumption, commission rates; etc.	

* SEC filings of American, Continental, Delta, Northwest, United, and US Airways

The Government Responds

ATSSSA provided an infusion of \$5 billion in recognition of the effects of the system shutdown and its longer-term impact

The federal government moved rapidly, post-9/11, to respond to the threat of attacks on the United States by aviation terrorists and the risk of immediate airline industry bankruptcy. The Air Transportation Safety and System Stabilization Act (ATSSSA) of September 22, 2001, provided an industry "life-saving" infusion of \$5 billion in recognition of the effects of the system shutdown and its longer-term impact. In addition, \$10 billion in possible loan guarantees were made available to qualified applicants. Notwithstanding the beneficial effect of the stabilization payments, which were subject to taxation, the resulting 2001 net loss to the industry exceeded \$7.7 billion. (Originally, pre-9/11, this loss was projected at \$3.5 billion; without the stabilization offset it likely would have topped \$12 billion.)

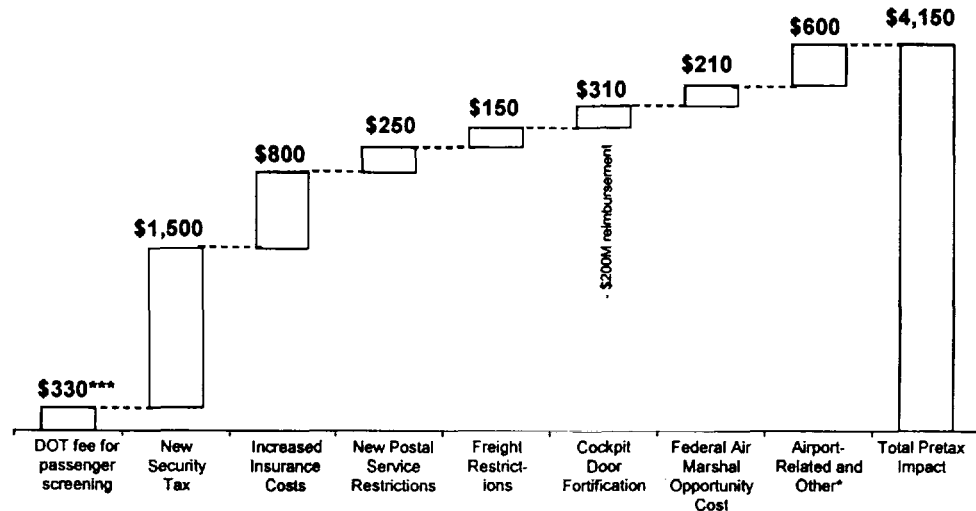
Subsequently, with the enactment of the Aviation and Transportation Security Act (November 16, 2001), the Transportation Security Administration (TSA) was established and, with it, a new era of aviation security. Working with the industry, TSA has established vastly different and improved security processes and procedures. With well-intentioned and very valuable government action, of course, other results have followed. The following chart demonstrates the estimated incremental pre-tax costs to the airlines of post-9/11 government policy decisions. These costs include both the direct, out-of-pocket costs for new unfunded security mandates imposed on the airlines or billed to the airlines through the airports, lost revenues resulting from security policies, and payments made directly to the federal government by the airlines and their customers. As a result of competitive forces at work in the industry, the absence of industry pricing power results in government imposed taxes and fees directly reducing industry revenue on virtually a dollar-for-dollar basis.

Chart 10

Financial Impact of Post-9/11 Policies

Estimated Incremental Industry Pretax Costs (\$ Millions), 2002 **

Post-9/11 taxes, fees and unfunded mandates have added more than \$4 billion to the industry's annual burden



* Includes ramp security, aircraft inspections, checkpoint document verification, queue management, exit lane monitors, screening of catering supplies and materials, airport space occupied by TSA, security equipment, training, fingerprinting, background checks, employee ID badge program, increased airport rents and landing fees, and airport capital modifications.

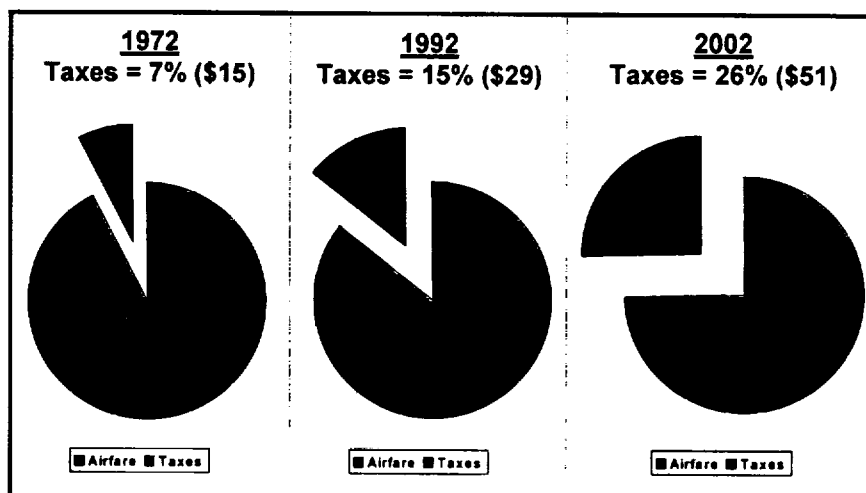
** All numbers extrapolated from estimates developed by Alaska, America West, American, American Eagle, American Trans Air, Atlantic Southeast, Comair, Continental, Delta, Express Jet, Horizon, JetBlue, Midwest, Northwest, Southwest, United, United Express, US Airways.

*** Approximated according to TSA reports.

Chart 10 is also helpful in understanding the magnitude of the problem confronting the airline industry. Despite the airlines' massive self-help measures undertaken in response to the 9/11 crisis, the inexorable growth of other expenses—beyond the control of the industry to manage and resulting in substantial measure from government action—has significantly contributed to the deepening economic meltdown of the industry. Post-9/11 taxes, fees and unfunded mandates have added more than \$4 billion to the industry's annual burden.

Chart 11

**Taxes and Fees on a \$200 Roundtrip Ticket
(Single-Connection With Maximum PFC)**



The 76 percent increase in industry taxation between 1992 and 2002 must be a cause for alarm

On the related point of tax policy, Charts 11 and 12 demonstrate both the impact of government tax policies on the airlines, and draw attention to the implications of high rates of taxation on a fragile industry. The 76 percent increase in industry taxation between 1992 and 2002 must be a cause for alarm. The risk that these tax rates, combined with the impact of security policies, have overwhelmed the fragile economic balance that has been maintained by the airline industry in the past is very real.

Table E

Federal Aviation Taxes and Fees

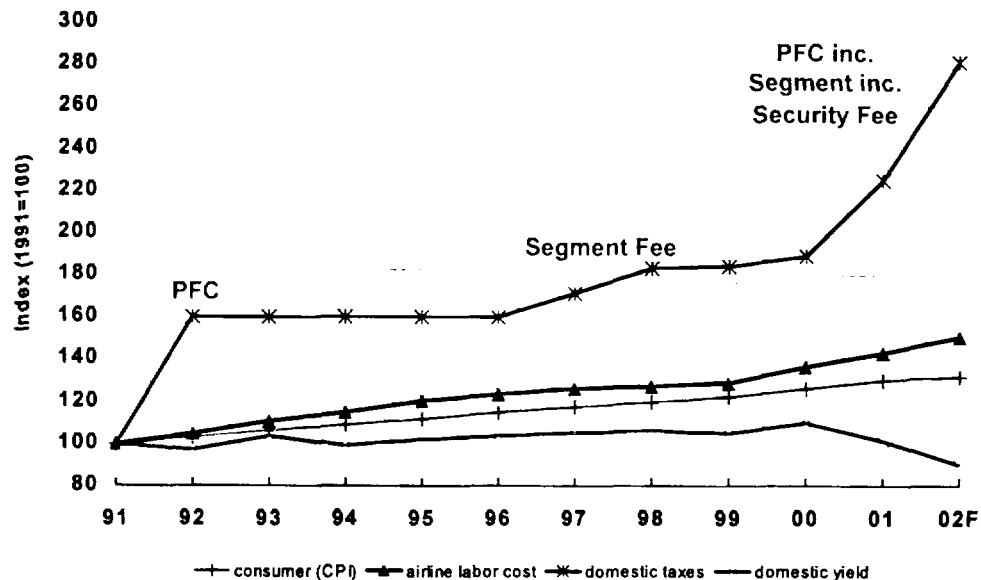
<u>Tax/Fee</u>	<u>1972</u>	<u>1992</u>	<u>2003</u>	<u>R/T***</u>
Passenger Ticket Tax*	8.0%	10.0%	7.5%	nmf
Passenger Flight Segment Tax*	-	-	\$3.00	\$12.00
Passenger Security Surcharge	-	-	\$2.50	\$10.00**
Passenger Facility Charge	-	\$3.00**	\$4.50**	\$18.00**
International Departure Tax	\$3.00	\$6.00	\$13.40	nmf
International Arrival Tax	-	-	\$13.40	nmf
INS User Fee	-	\$5.00	\$7.00	nmf
Customs User Fee	-	\$5.00	\$5.00	nmf
APHIS Passenger Fee	-	\$2.00	\$3.10	nmf
Cargo Waybill Tax*	5.00%	6.25%	6.25%	nmf
Frequent Flyer Tax	-	-	7.5%	nmf
APHIS Aircraft Fee	-	\$76.75	\$65.25	nmf
Jet Fuel Tax*	-	-	4.3¢/gal	nmf
LUST Fuel Tax*	-	0.1¢/gal	0.1¢/gal	nmf
Air Carrier Security Fee	-	-	TBD	nmf

*Tax applies only to domestic transportation; prorated on flights between mainland U.S. and Alaska/Hawaii

**Legislative maximum

***Single-connection roundtrip with \$4.50 PFC

Chart 12

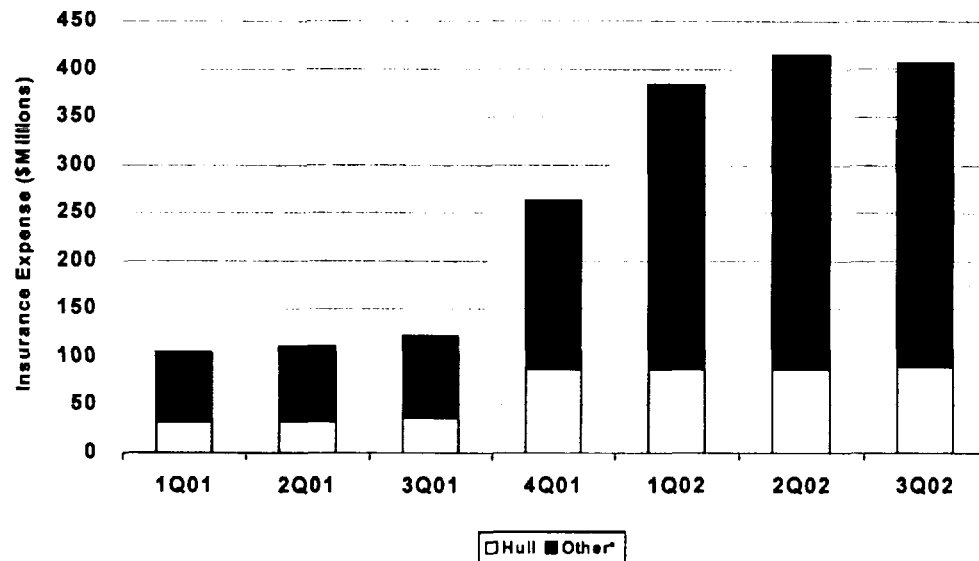
Aviation Taxes Have Outpaced Inflation and Airfares**The Role of Insurance**

Following the 9/11 terrorist attack, overall liability insurance costs for U.S. airlines more than tripled. War-risk insurance, which had been provided at no cost or for only one or two cents per passenger, became prohibitively expensive. After 9/11, insurers, not sure of the actual risks, priced war-risk insurance at rates that airlines could not afford. (For example, one insurer offered war-risk insurance for \$2.25 per passenger, which would have cost the U.S. airline industry nearly \$1.4 billion annually.)

The FAA in late September 2001 responded to the turmoil in the insurance markets by providing third-party war-risk insurance to U.S. airlines. Recognizing that the markets still were not offering war-risk insurance on reasonable terms, Congress last fall in the Homeland Security Act instructed the FAA to expand, at least through August 31, 2003, its war-risk policies to include coverage for passengers, crew and hulls (aircraft). This coverage is costly—roughly \$140 million annually for the U.S. airline industry—but it is far more economical than obtaining coverage commercially.

As a further recognition of the adverse circumstances and the terrorist threat against the industry, the Act reinstated the \$100 million act-of-terrorism liability cap that first had been enacted in the Air Transportation Safety and System Stabilization Act of 2001.

Chart 13

Airline Insurance Costs: 2001-02

* Passenger, cargo and corporate liability

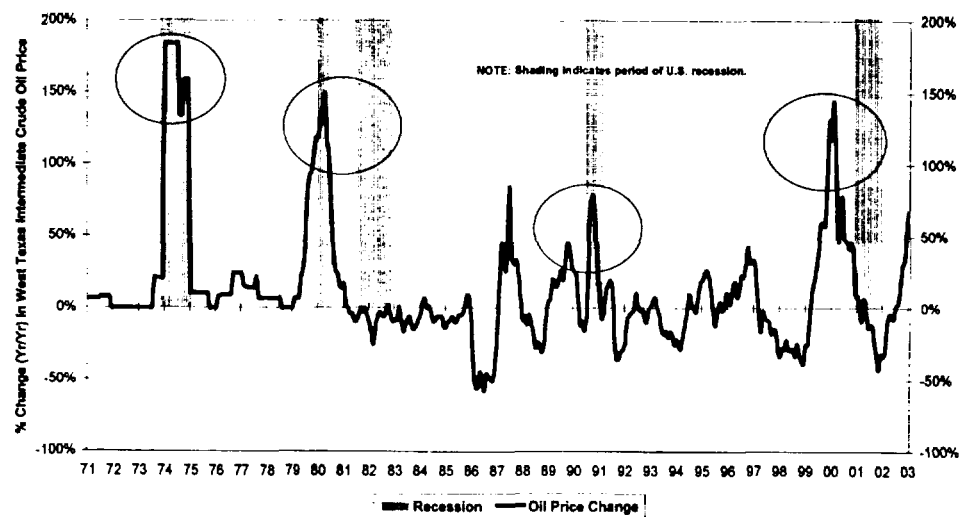
The Role of Fuel

Every one-cent increase in the cost of a gallon of jet fuel costs the industry \$180 million per year

Fuel constitutes the industry's second-largest operating expense. During times of relatively moderate fuel prices, these costs average 10 to 12 percent of industry expenses. Currently, these costs are pushing 15 percent—and with every one-cent increase in the cost of a gallon of jet fuel costing the industry \$180 million per year, the exposure of the industry to price escalation is severe.

Beyond its direct impact, another aspect of an energy price increase is the relationship between energy, the economy and air travel. The link between energy prices and the health of the economy is clear. The major recessions of the past 30 years can, in large measure, be attributed to the steep increase in energy prices. The airline industry is inextricably tied to the overall economy—even minor recessions result in reduced demand and increased sensitivity to prices for leisure as well as business travelers.

Chart 14

Oil Shocks Trigger Recessions

Past fuel spikes and attendant recessions have brought about widespread hardship in the airline industry. Airline profitability suffers as a direct consequence of a weakening economy.

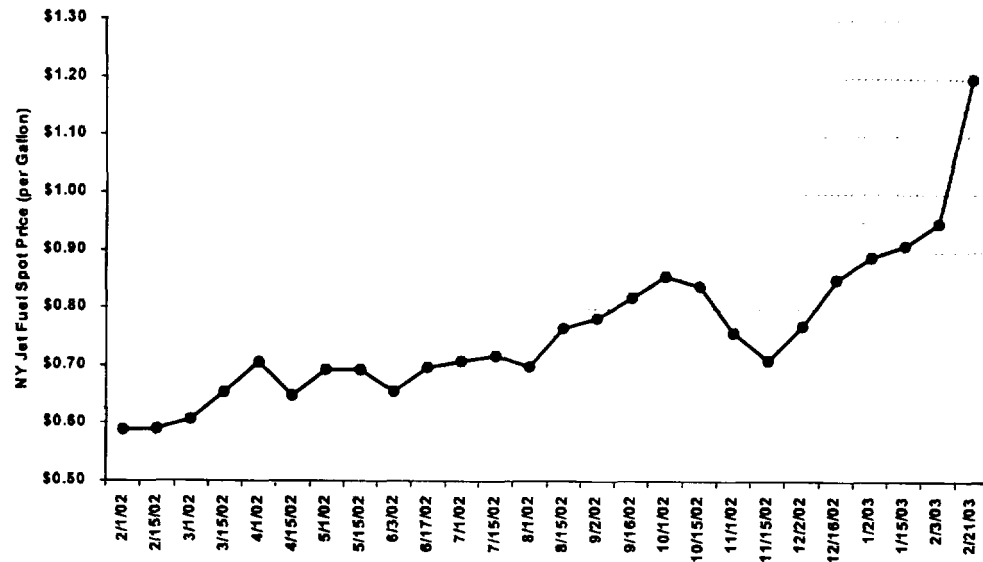
The airlines are doing everything they can to conserve fuel. Throughout the history of commercial aviation, airlines have insisted upon the most fuel-efficient aircraft possible and have worked with airframe and engine manufacturers to reduce fuel consumption. Today's fleet is nearly three times more fuel-efficient than the fleet we were operating at the time of the first OPEC fuel crisis. In fact, our conservation efforts have resulted in a fuel consumption rate of almost 40 passenger miles per gallon in today's aircraft—a rate that compares favorably with the most fuel-efficient automobiles.

Unfortunately, once again, the bottom-line is a massive increase in industry losses. During the first 11 months of 2002, spot prices for jet fuel rose 27 percent. Just since last December, spot prices have risen an additional 55 percent.

By the end of February 2003, spot prices had reached \$1.20 per gallon, a 108 percent jump from February 2002.

Chart 15

Market Price of Jet Fuel



While carriers have employed various hedging strategies to deal with the situation, the additional impact on the industry of Jet A prices remaining at current levels for just two quarters would be on the order of \$3.6 billion.

The Perfect Storm

Between customer avoidance of air travel, government tax and security policies, insurance, escalating fuel prices and the general state of the United States and world economies—and despite massive and ongoing industry self-help efforts eliminating billions in expenses—industry losses continue to accumulate. The 2001 loss of \$7.7 billion (which reflected the stabilization payments) was exceeded by the 2002 reported loss of more than \$10 billion.

Table F

Changes Since 9/11 for Airlines With More Than \$100M Revenue

	2000	2001	2002 prelim	2002 Changes vs. 2000
Net Profits/(Losses)	\$2.6B	\$(7.7)B	\$(9.5)B	\$(12.1)B
Traffic (RPM)	690.9B	649.0B	634.3B	-8.2%
Passengers	663.3M	618.8M	601.4M	-9.3%
Daily Flights	25,200	24,400	23,100	-8.3%
Employment	659,600	655,400	584,700	-74,900
Fuel Cost (per gallon)	78.9¢	78.6¢	71.5¢	-9.4%
Airfares	\$135.60	\$124.60	\$114.70	-15.4%
Load Factor	72.4%	70.0%	72.1%	-0.3 pts
Breakeven Load Factor	70.4%	76.7%	81.4%	+11.0 pts

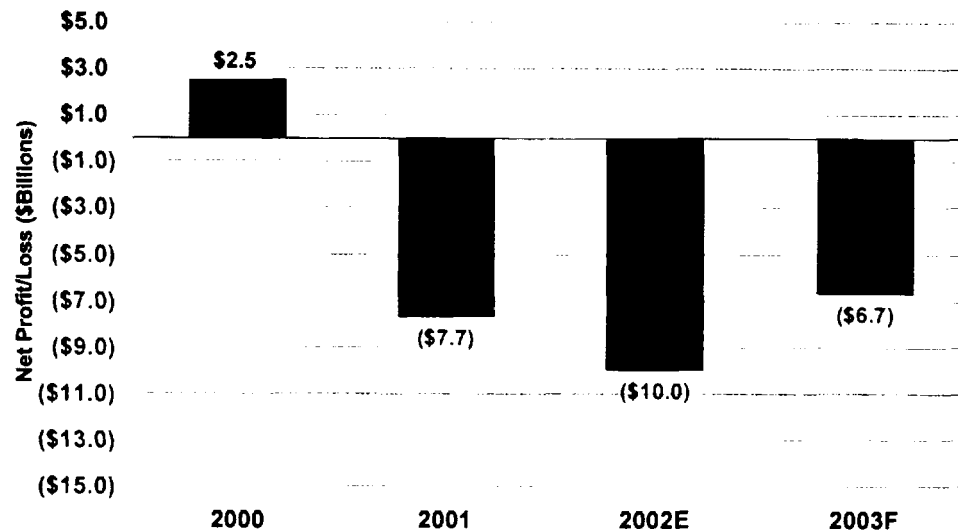
Notes:

1. This data is for the Major and National airlines. This DOT category includes all airlines with more than \$100 million in operating revenues.
2. Self-help measures are clearly visible in the reduction in the number of flights, and the reduction in employment. These two categories afford the greatest possibility for management to lower expenses. Of course, many other steps have been taken as well.
3. Airlines have sharply lowered prices in order to attract as many travelers and shippers as possible. Demand for travel is elastic. That is, by lowering prices, volume will be stimulated and revenue will rise. However, demand for business travel is less price elastic than leisure travel. That is, when business travel prices are reduced, volume may not increase commensurately. With the slumping economy, business travelers have benefited from lower price levels, but business travel volume is still well below 2000 levels.
4. The employment reductions reflect average annual values. When calculated from peak employment to trough, the reductions are even greater.
5. The sharp rise in the breakeven load factor is driven by two factors -- lower prices and higher costs. When prices go down, more seats must be filled to generate breakeven revenues. When costs rise, more seats must be filled to cover those higher costs.

Despite massive and ongoing industry self-help efforts eliminating billions in expenses, industry losses continue to accumulate

For 2003, "base case" estimated losses (premised upon first-quarter performance and projected fuel costs) will exceed \$6.7 billion. Should current estimates prove valid (which as noted below is unlikely in the event of an active war in Iraq) the industry will stand to have lost, at a minimum, almost \$25 billion from 2001 through 2003. Depending upon the course of a war, these losses could worsen significantly.

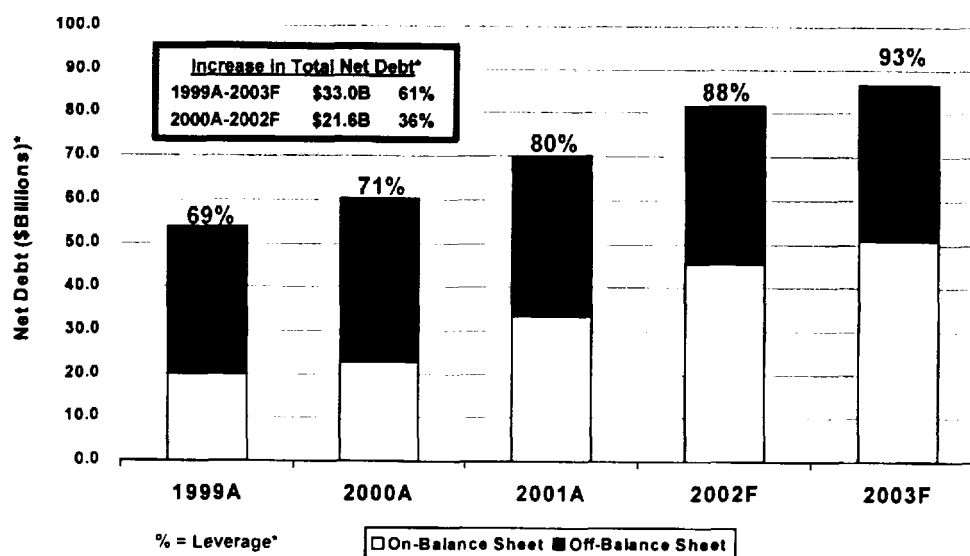
Chart 16

Airline Industry Net Income/(Losses)

In order to remain in business and continue to provide essential transportation, the airlines have assumed massive debt burdens to cover their losses. The industry is now carrying over \$100 billion in debt. The 11 largest passenger carriers alone are 90 percent leveraged, with debt approaching \$90 billion. At the same time their credit ratings have declined—with debt of nine of the nation's 10 major airlines rated "junk."

Chart 17

Airline Industry Leverage*



* Net Debt = LTD + STD + Capitalized Operating Leases – Cash and Short-Term Equivalents as of December 31; Leverage = Net Debt / Total Capital

Source: Salomon Smith Barney estimates for AirTran, Alaska, American, America West, ATA, Continental, Delta, Northwest, Southwest, United, US Airways

Table G

Airline Credit Ratings – Standard & Poor's

	9/10/01	3/5/03	Change
Southwest	A	A	—
Alaska	BB +	BB	(1)
Delta	BBB-	BB	(2)
Northwest	BB	BB-	(1)
Continental	BB	B+	(2)
AirTran	B	B-	(1)
America West	B+	B-	(2)
American Trans Air	B+	B-	(2)
American	BBB-	B-	(6)
US Airways	B	D	(8)
United	BB+	D	(9)

Stock prices have plummeted as well. By the end of February 2003, the outstanding stock value of the entire network-carrier industry had plummeted to only \$3.2 billion. The industry is financially depleted and “going down for the last count.” It does so at grave risk to our broad, national, transportation-dependent economy.

Section III

Aviation's Critical Role in the U.S. Economy

The importance of civil aviation to the economy, to the nation, and to the quality of life of Americans was made readily apparent by the terrible events of September 11, 2001. Layoffs and financial losses in civil aviation, its supplier industries, the tourism industry and the broader economy rose sharply.

For every job in the airline industry, 15 jobs are produced in the broader economy

According to the authoritative 2002 *National Economic Impact of Civil Aviation* study conducted by DRI-WEFA, Inc. and the Campbell-Hill Aviation Group, Inc., the total 2000 impact of the commercial aviation sector in the United States exceeded \$800 billion (8 percent) in GDP and 10 million jobs.

More fundamentally, air transportation powers our national economy—it links our communities together; it delivers vital, high-value goods; it produces jobs across the spectrum including our largest sector of employment, travel and tourism; and it drives just-in-time delivery vital to our productivity. There is quite literally no aspect of life in the United States that does not benefit from aviation.

When aviation experiences economic difficulties, those difficulties reverberate across the economy. For every job in the airline industry, an estimated 15 jobs are produced in the broader economy. It is not surprising, therefore, to learn that in the travel and tourism sector of the economy alone, more than 460,000 jobs have ceased to exist in our post-9/11 economy. With nearly 100,000 of these jobs coming directly from the airlines, the ripples grow. Job losses for aerospace workers are obvious—less so are the jobs lost in every other sector that depend upon those nearly half-million lost jobs.

Table H

Employment Impact of Civil Aviation by Sector, 2000 (000s of Jobs)

	Direct	Indirect	Induced	Total	Percent
Retail Employment	1,022	586	669	2,277	20%
Transportation	1,381	610	131	2,122	19%
Other Manufacturing	0	310	925	1,235	11%
Mining and Construction	393	117	218	728	6%
Wholesale Employment	0	490	182	672	6%
Transportation Equipment	380	65	122	567	5%
Finance, Insurance and Real Estate	0	184	213	397	4%
Public Utilities and Communications	0	61	167	229	2%
Other	1,059	787	1,175	3,022	27%
Total	4,234	3,212	3,802	11,248	100%
Percent of Total	38%	29%	34%	100%	

Source: DRI-WEFA, Inc.

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As discussed later, the prospect for the loss of an additional 100,000 airline jobs is very real. With such a loss, some 3,800 daily flights would be eliminated. With that action, mid- and small-size communities would suffer significant service reductions, including the likely elimination of air service to many smaller communities.

Civil aviation has become an integral part of the U.S. economy. It is a key catalyst for economic growth and has a profound influence on the quality of life around the globe. It integrates the world economy and promotes the international exchange of people, products, investments and ideas. Indeed, to a very large extent, civil aviation has enabled small community and rural populations to enter the mainstream of global commerce by linking such communities with worldwide population, manufacturing and cultural centers. Fundamentally, civil aviation touches nearly every aspect of our lives, and its success will, to a great degree, shape American society and the U.S. economy in the coming decades.

The United States possesses the largest, most extensive aviation system in the world with more than 18,000 landing facilities, ranging from large commercial airports serving millions of passengers annually to small grass strips accommodating only a few aircraft each year. Of the nation's more than 500 commercial service airports, over 400 enplane more than 10,000 passengers annually and are classified as primary airports. Of these, 50 are responsible for 70 percent of commercial traffic. The FAA records some 7,000 aircraft owned by commercial air carriers, of which over 6,000 are large aircraft, defined as having a seating capacity of more than 30 seats or a maximum payload capacity of more than 7,500 pounds carrying passengers or cargo for hire or compensation.

In 2000, U.S. airlines carried 666 million passengers and registered 24 billion ton miles of cargo on nine million scheduled departures. U.S. airlines also carried 11 million passengers and over six billion ton miles of cargo on 400,000 non-scheduled departures.

Economic deregulation of airlines in the late 1970s stimulated competition from both existing firms and new entrants. Intensified competition spurred innovations in marketing, operations, technology, and governance that enabled firms to become more efficient, improve service quality, introduce new services, and become more responsive to consumers' preferences. Air travelers enjoyed a 38 percent decline in real average fares through 2000 and 79 percent greater service (as measured by departures), concurrent with an increase in revenue passenger miles of 200 percent. Fares fell rapidly and personal travel by air became the norm after deregulation. Airlines accelerated development of network route structures to increase flight frequency and to broaden the scope of services to include many previously unserved or underserved small and medium markets, while taking advantage of the efficiencies of the hub-and-spoke system.

With deregulation, air cargo networks were able to facilitate just-in-time shipping, providing expanded services at lower costs. Optimization of just-in-time shipping allows short production and development cycle times and eliminates excessive inventory in the logistics chain regardless of facility location. Without the availability of ubiquitous, reliable, efficient air express service, U.S. businesses would be unable to realize the competitive economies of just-in-time production. Air transportation offers many cost advantages—lower lead times, quicker customer response times, improved flexibility, and reduced inventory. Many high-tech, high-value industries have embraced air transport for its time and cost advantages in manufacturing and distribution, and because it improves delivery reliability by providing time-definite guarantees.

Section IV

War With Iraq

The anticipated impacts on the airline industry of a war with Iraq raise the risk of an economic catastrophe to crisis levels. Nationalization of the industry as a result of wholesale airline bankruptcies is conceivable.

The grave condition of the industry entering into the war, as outlined in Section II, is already being worsened by reductions in travel brought on by public concerns—avoiding international travel, not wanting to be away from home in the event of hostilities, fear from terrorist reprisal attacks—all are combining to dampen demand below its already weak levels.

Bankruptcy
is certain
for multiple
airlines at
the loss
levels
estimated
in the most
likely war
scenario

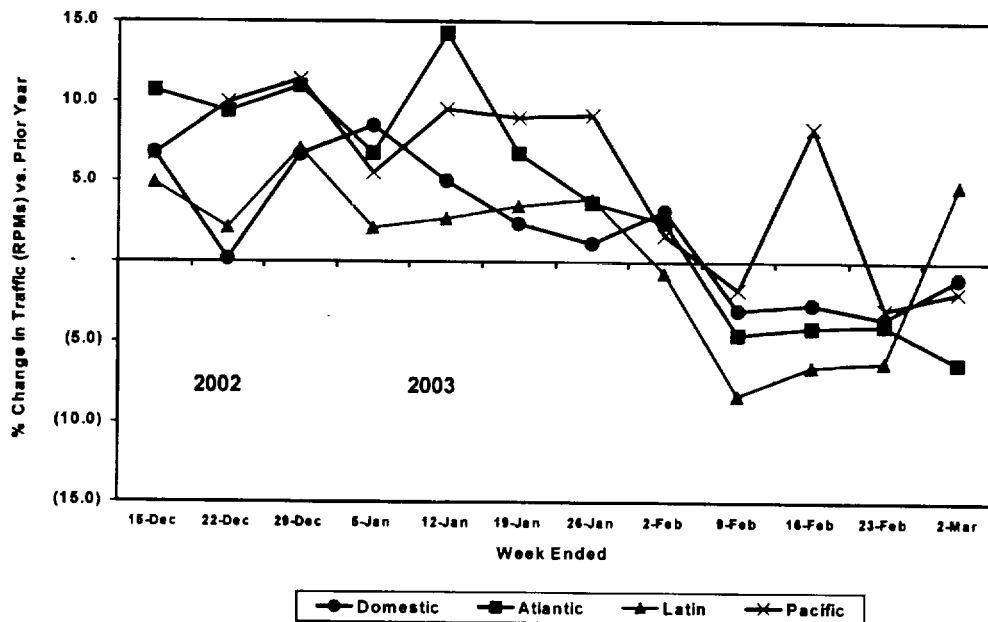
In an effort to quantify the likely impact of war on the airline industry, the following scenarios put forward four “case studies” of the prospects. The studies, which range from the Base Case/No War scenario through the full first Gulf War experience combined with a major terrorist incident (with an impact similar to the 9/11 attack), provide what is believed to be a conservative and reasonable picture of likely outcomes. Each case is based upon all fighting occurring during the second quarter of 2003. To the degree possible, actual advance booking data were incorporated into this analysis. In each scenario, carrier loss mitigation actions (further drastic cuts in capacity and staff) are factored into the calculation.

The data, which follow, along with the operative assumptions, set forth a bleak picture with best-case 2003 losses to the industry in the \$6.7 billion range without any Iraq War. This estimate is based upon actual first-quarter 2003 operating data. Earlier estimates, projecting a \$5 billion to \$6 billion loss, have already been proven overly optimistic.

Moving up the scale, and primarily for comparison purposes, a scenario equivalent to the first Gulf War—which is believed highly unlikely since fares actually rose in that period—would result in a \$7.6 billion loss.

The most likely war scenario produces industry losses \$4 billion higher than the base case, for total losses of \$10.7 billion. This analysis projects a 15 percent traffic decline during one quarter of “active” war activity. This is based upon actual carrier advance booking information, which declined internationally by more than 20 percent following the recent Code Orange security alert. Advance booking data are corroborated by weekly traffic data collected by ATA. Since mid-December, year-over-year traffic growth rates have fallen sharply in every geographic entity served by U.S. airlines, with the biggest declines in the Atlantic. Based upon historic patterns from traffic declines and the slow rate of returning traffic under this scenario, the last quarter of 2003 could see traffic levels no higher than those experienced in 1997. At these loss levels, sequential airline bankruptcies are inevitable.

Chart 18

Industry Traffic Growth Rates Plummeting as Anticipated War Approaches

Source: America West, American, Continental, Delta, Northwest, United, US Airways

Finally, a conservative worse-case scenario projects losses of \$13 billion based upon a Gulf War-type experience combined with a terrorist attack of 9/11 magnitude. While current conditions mean airlines must fill 80 percent of seats to break even—an unprecedented annual requirement—such an eventuality would raise the bar to 92 percent. Under this \$13 billion loss case, a total industry collapse is virtually certain.

Iraq War Scenarios

Table I

Anticipated War Losses
(2003 scenarios compared with 2002 base)

2003 Scenarios	Base Case - No War	Gulf War Equivalent	Most Likely	Gulf War Equivalent Plus Terrorism
Net Profits/(Losses)	\$(6.7)B	\$(7.6)B	\$(10.7)B	\$(13.0)B
Traffic	+5%	-3%	-8%	-12%
Passengers	+28M	-18M	-52M	-75M
Daily Flights	+500	-700	-2,200	-3,800
Employment	+11,000	-31,000	-70,000	-98,000
Fuel Cost (per gallon)	83¢	78¢	93¢	110¢
Airfares	+0.2%	--	-4%	-9%
Load Factor	73%	72%	73%	75%
Breakeven Load Factor	80%	80%	85%	92%

Assumptions:

1. In all cases, the war is expected to last for one quarter (90 days). Obviously, the impacts would be magnified if the war were to last longer.
2. The Base Case assumes there is no war and shows how the airline recovery might continue after two years of losses following the 9/11 terrorist attacks. It assumes a growing economy, which would be the principal driver for increased traffic levels.
3. The Gulf War Equivalent scenario is based on domestic traffic falling 5 percent while international traffic falls 15 percent. The overall traffic decline would be 7.8 percent and recovery to pre-war levels would take about six months. Fuel prices would fall sharply following a quarter in which they have spiked higher. Airfares are assumed to rise by 3 percent during the war but fall slightly during the recovery.
4. The Most Likely scenario is based on information from airlines on advance bookings for March and April compiled specifically for this report. These advanced bookings suggest that traffic will fall more sharply than during the Gulf War I. Further, the Most Likely scenario assumes that an Iraqi war on top of the already depleted crude oil inventories will continue to see high but modestly declining crude prices. As after the 9/11 terrorist attacks, airlines are expected to try to attract travelers with lower prices.
5. The Gulf War Equivalent scenario coupled with a terrorist attack within the U.S. is expected to bring even more difficult circumstances. During the 1991 Gulf War, airline traffic across the Atlantic initially declined by 43 percent. In this case international traffic is assumed to decline by that amount for a full quarter and domestic traffic is assumed to fall by 25 percent. Crude prices are projected to increase sharply in this case.

BASE CASE ASSUMPTIONS

Net Losses	After recording losses totaling nearly \$10 billion in 2002, the industry is able to make some progress in reducing losses in 2003 to \$6.7 billion.
Traffic	With a growing economy, airline traffic shows continued improvement with a 5 percent growth rate but still does not return to 2000 levels.
Passengers	The number of passengers grows by 28 million or about 76,000 per day.
Daily Flights	To accommodate the growing number of passengers, airlines add about 500 daily flights.
Employment	To handle the increased flow of passengers and freight, airlines add about 11,000 employees—about 2 percent. The increase in employment is less than the increase in the number of passengers because of increasing productivity of the workforce.
Fuel Cost	Current fuel prices are running at over 100 cents per gallon. With the Venezuelan strike behind us, energy costs are expected to moderate.
Prices	Fares are currently running at 1988 levels, without adjustment for inflation. Prices have been very weak because of the slack demand for air travel. With increasing demand in 2003, airlines may be able to put in place a modest 3 percent fare increase.
Load Factor	The percentage of seats filled is expected to reach a record high of 73 percent as carriers add capacity more slowly than the increase in passenger and cargo demand.
Breakeven Load Factor	Although the industry is expected to reach a record load factor in 2003, prices remain very low and costs very high, so that the breakeven load factor remains seven points above the actual load factor. A price increase would reduce the number of seats needed to be filled to break even, and decreases in costs—especially labor and fuel—would reduce the breakeven load factor.

GULF WAR EQUIVALENT SCENARIO

Net Losses	Losses would grow to \$7.6 billion principally because of the decline in the number of passengers.
Traffic	When fighting began in the Gulf in 1991, traffic declined by 8 percent and took about a half-year to recover to pre-war levels. For the full year, 1991 traffic declined by 2 percent. This scenario assumes the same quarterly 8 percent decline in traffic and assumes that by the fourth quarter, traffic will be back to fourth quarter 2002 levels. It should be noted that fourth quarter 2002 traffic was still 8 percent below the fourth quarter of 2000.
Passengers	An eight percent decline in passenger traffic equates to 13 million fewer passengers in the quarter. For the full year, a 3 percent decline in the number of passengers equates to 18 million less than in 2002.
Daily Flights	During the Gulf War, flights were not reduced in proportion with the decline in passengers, and load factors fell. This scenario assumes a slightly greater reduction in flights, with a proportionately greater reduction in fuel and labor costs.
Employment	Net employment for the year will average 31,000 fewer than in 2002.
Fuel Cost	During the Gulf War, fuel prices declined from the highs established in the preceding quarter when Iraq had invaded Kuwait. This scenario also assumes a sharp decline in jet fuel prices from the preceding quarter. With the cut in the number of flights, fuel consumption is expected to be reduced by over 500 million gallons. At the assumed price of 78 cents per gallon, airlines would save nearly \$400 million.
Prices	During the Gulf War, fares increased. We have assumed that same increase in this scenario. <i>However</i> , it seems unlikely that airlines (who were unable to raise prices in 2002 because of weak demand) would be able to raise prices in the face of weaker demand. Nonetheless, to closely replicate the experiences of the Gulf War, a 3 percent increase is assumed for the period of the war followed by a 1.4 percent quarterly (year-over-year) decline and a 0.4 percent increase. These price moves are identical to the price changes of the Gulf War. A more likely outcome is that airlines would continue to lower prices and losses would widen.
Load Factor	With flights and capacity cut, load factor is assumed to remain close to the near record levels of 2002. If flights and capacity were cut less aggressively (as in the Gulf War) load factors would be lower and losses would widen.
Breakeven Load Factor	The breakeven load factor is driven higher principally by higher unit costs. Although airlines will cut employment and fuel consumption, average compensation per employee is expected to rise slightly. Laid off employees come from the low end of the seniority lists. The remaining employees tend to be more highly compensated because they are more senior. Unit fuel costs (price per gallon) are assumed to be seven cents per gallon higher than in 2002. Over the last 10 years the average price per gallon of jet fuel has been 63 cents. The last three years have seen jet fuel prices of 79, 79 and 72 cents. These fuel costs that have been far above the long-term average price are a big part of the losses experienced by the airlines.

MOST LIKELY IRAQI WAR SCENARIO

Net Losses	Net losses would be expected to increase by \$4 billion over the base case (no war) scenario. These losses would be principally driven by the decline in traffic coupled with a decline in price and an increase in the price of fuel.
Traffic	Based on advanced booking information supplied by ATA member airlines, traffic is expected to decline more sharply than in Gulf War I. Carriers have indicated that following the move to Code Orange security level, international advance bookings declined by more than 20 percent. In this case, we have assumed a 15 percent decline in the quarter in which fighting occurs followed by quarterly declines of 10 and 7 percent. By the fourth quarter of 2003, traffic levels would be expected to be at levels that are similar to 1997. These low traffic levels would be the combined result of having not yet recovered from the 9/11 terrorist attacks and the added impact of a second Gulf War. It would then take several years of steady growth to return to 2000 traffic levels.
Passengers	These lower traffic levels equate to 52 million fewer passengers carried in 2003—an 8.6 percent reduction compared to 2002 and 17 percent below record 2000 levels.
Daily Flights	Carriers are expected to react aggressively to the decline in traffic by cutting service equally sharply. Flights are expected to be reduced by 2,200 per day—a 9.5 percent cut for the full year.
Employment	Unfortunately, employees bear the brunt of self-help measures undertaken by airlines. The workforce is expected to be reduced by 70,000 in this case.
Fuel Cost	Fuel costs are expected to rise. Crude oil inventories have been reduced to very low levels by the Venezuelan strike, making the nation more vulnerable to supply disruptions from the Middle East. Even though the Venezuelan situation seems to be resolving, crude prices and jet fuel prices are continuing to rise.
Prices	Airlines will struggle to regain their lost customers by further lowering prices. This was the pattern followed after the 9/11 terrorist attacks. ATA expects that airlines will continue to cut prices in order to stimulate demand. In this most likely scenario, we expect prices to fall about four percent compared to the eight percent declines in 2001 and 2002 triggered by the 9/11 attacks.
Load Factor	With aggressive capacity cuts and their attendant cost reductions, airline load factors are expected to reach record levels.
Breakeven Load Factor	Even with many cost cutting measures in place, the breakeven load factor is expected to increase to an extremely high 85 percent.

GULF WAR EQUIVALENT PLUS TERRORISM SCENARIO

Net Losses	Although many people are working hard to avoid this scenario, it must be assigned a relatively high probability. If a terrorist attack occurs in the U.S., passenger volumes would be sharply reduced and losses would be unbearable. ATA believes that losses could amount to \$13 billion and would threaten the continued viability of the industry.
Traffic	Another terrorist attack would send traffic plummeting. During Gulf War I and following the 9/11 terrorist attacks, Atlantic traffic initially declined by 43 percent. In this scenario all international traffic is assumed to decline by that amount for a full quarter and domestic traffic is assumed to fall by 25 percent. For the full year, traffic could fall by 12 percent, bringing the industry back to 1995-1996 traffic levels. It would take years to recover.
Passengers	Passenger enplanements would drop by 75 million. Considering the No War scenario, this represents a passenger decline of more than 100 million from those expected levels.
Daily Flights	Airlines would react aggressively to cut their costs. Airline flights would be reduced by some 3,800 daily flights. Service to many small- and medium-sized communities would be eliminated.
Employment	Employment levels would be cut by nearly 100,000 employees, bringing the total reduction in force from 2000 to 2003 to nearly 175,000 or more than 25 percent of the workforce.
Fuel Cost	Fuel costs are currently as high as the spike that preceded Gulf War I. In this scenario we have assumed that they remain at those very high levels through the war and decline slowly during the following quarters.
Prices	Lower prices are expected to recoup lost traffic. In this scenario price reductions are assumed to be about the same as those that followed the 9/11 terrorist attacks.
Load Factor	With even more aggressive capacity cuts, load factors are assumed to increase to record levels—reaching 75 percent.
Breakeven Load Factor	Although airlines will aggressively cut costs, breakeven load factors are expected to rise to impossibly high levels—reaching 92 percent for the year.

Section V

Conclusion

A key pillar of our nation's economy—our airline system—is suffering from extraordinary adversity brought about by the 9/11 terrorist attacks on America. The forces at work are well beyond “normal” market fluctuations and reflect the stated goal of the terrorists to bring down the United States by attacking its key institutions.

Over the past eighteen months, both the United States government and the airline industry have taken decisive steps to defend and stabilize this critical economic engine. While the steps have been difficult, painful and expensive, they have been essential. For the airlines, massive job losses, massive new costs, and radical airline capacity cuts, among the other measures outlined in this report, have been undertaken to try to keep the airlines flying. The government has been equally aggressive in establishing new security processes and procedures.

As our long national fight against terrorism continues, however, still greater “non-market” adversity is on the horizon for the airline industry. The mere prospect of war with Iraq has already further weakened this industry, which is literally struggling to survive. As the prospects for war mount, and its likely scenarios are projected, it becomes starkly clear that wholesale bankruptcies in the airline industry, major airline liquidations and even the forced nationalization of our airline system are the risks we confront.

There remains a short window of opportunity if we are to avoid this likely outcome. The government can and should act with dispatch to reduce the burdens currently imposed on the airline industry. While the airlines must be expected to deal with normal forces in a free market, the government must recognize and respond to the extraordinary, non-market forces that have produced the crisis in the industry.

The time for decisive government action to maintain this essential key to our economic success is now.



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EXHIBIT 9

Final Report

**ASSOCIATION OF
EUROPEAN AIRLINES**

**ECONOMIC AND POLITICAL
ANALYSIS OF COMPUTER
RESERVATION SYSTEMS**

OCTOBER 2001



GPC International
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Executive Summary

The Association of European Airlines (AEA) has engaged GPC and OXERA to investigate the computer reservation system (CRS) economic model and the European Union (EU) regulations that govern the relationships between airlines and CRSs. The objectives are:

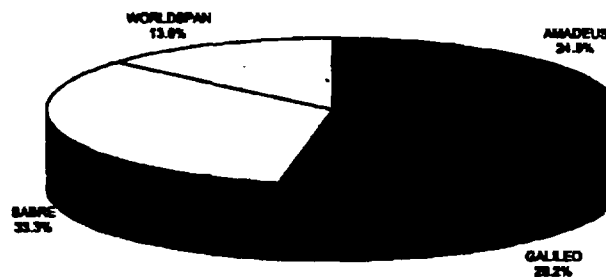
- to identify options that would change the working model between airlines, agents and CRS service providers to facilitate better competition across functionality, quality and price, by introducing increased market forces or more effective regulation;
- to influence the EU in the short term to address some of the ongoing concerns about non-compliance with the Code of Conduct and to improve the bargaining power of airlines with respect to CRSs.

CRSs are involved in the business of travel distribution—they act as intermediaries between suppliers of travel services (airlines, hotels and car-rental companies) and distributors of such services (travel agents, Internet travel agents). The central role is one of information transfer; data are stored about current service providers and the CRSs provide the necessary infrastructure to transfer these data, facilitating the distribution of travel products between producers and travel mediators.

The CRS industry is dominated by four major companies: Sabre, Amadeus, Worldspan and Galileo. These companies grew out of the internal reservation systems developed by airlines from the early 1950s in the USA. Sabre was the first CRS to be developed, by IBM and American Airlines in the 1950s. It became operational in 1963, and was made available to travel agents in 1976. Other airlines responded to these developments by commissioning computer companies to develop similar systems, and the other main CRS companies evolved as the existing technology was modified and enhanced. While Galileo and Amadeus were founded by European airlines, their origins still lie in the CRS systems developed in the USA. Far-reaching ownership changes have taken place over the last 10 years, with the flotation of Galileo and Sabre, but airlines remain majority holders in Amadeus and Worldspan.

The strength of the major four CRS companies can be seen in the worldwide market share that each company commands.

Global distribution system market shares, 2000 (millions of air segments)



Source: Garrett Communications (2001), '2001 GDS Yearbook'.

The Council of Ministers adopted the CRS Code of Conduct Regulation (hereafter referred to as the Code) on July 24th 1989, as part of the package on air transport liberalisation within the EU. The motivation for the Code was to promote fair competition in the airline sector (ie, competition *between* airlines for passengers). The EU wanted to ensure that large airlines did not use their ownership of CRSs to promote and protect their own interests, by preferential bookings on parent carrier flights, or by raising barriers to entry for market entrants. The Regulation was covered by a block exemption (3976/87, and later by 3652/93) (see section 2.2).

In 1993, the Code was modified to ensure equal functionality between participating carriers and to oblige parent carriers to provide information to all CRSs. In a major part this was intended to ensure that there was fair competition *between* CRSs and it was intended that equal access to flight and pricing information would benefit travel agents, air carriers and ultimately consumers. The block exemption expired on June 30th 1998.

The Code was changed again in 1999 to place a greater responsibility on subscribers (travel agents) with the introduction of Annex II. The Annex was introduced in order to ensure that subscribers would not provide 'inaccurate, misleading or discriminatory' reservation services. It was also intended to prevent travel agents making speculative or fictitious bookings in order to maximise the incentives offered by suppliers.¹ Finally, the Code was extended to cover rail bookings.

The Code remains embedded in Council Regulation 2299/89 (323/99 is the most recent amendment) and the Commission must formally propose any changes for modification of the Code. Any modifications would almost certainly be adopted by the co-decision procedure, as a joint Regulation of the Council of Ministers and the European Parliament.

Against the industry and regulatory background laid out above, the aim is now to set these industry features within a standard competition law framework. By defining the market structure and more formally exploring the market power of the participants, a coherent analysis of the CRSs' actions is possible. More importantly, the likely success of a given remedy can be assessed against whether it addresses the underlying market problem.

The role that the CRS plays as an intermediary between airlines and agents means that two markets are focused on:

- an upstream global market for the distribution of airline information and reservation services for air travel to travel agents and system users; and
- a downstream market for the provision of information, booking and ticketing services for air travel services to agents, with national scope.

¹ Speculative bookings occur when a travel agent reserves seat inventory in anticipation of travel clients' demand. Fictitious bookings are those bookings initiated by a travel agent which are unrelated to any current or expected use by travel clients.

CRSs have significant market power over airlines because each controls a large proportion of travel agents in the downstream market. From the airlines' perspective, CRSs are not readily substitutable for one another, as each CRS controls access to an important share of passengers through its member travel agents. Additionally, there are significant barriers to entry into CRS supply, which means that new intermediaries are rare. It is argued that the conditions are not in place that would prevent any one CRS (and certainly the four taken together) behaving independently of their customer airlines. This independence is revealed by the fact that most airlines could not choose to cease to participate in any one of the four major CRSs, regardless of the contractual terms offered.²

In the downstream market, competition by CRSs for travel agency market share is observed, as would be expected. There appear to be two main components of a CRS's offer to an agency: the extent to which the CRS is tailored to the needs of the agent's main market; and the price of the service offered. However, the price element of that competition takes a perverse form. Whereas five years ago there were still a number of agencies paying CRSs for services, now most agencies seem to receive payments from CRSs, as well as receiving the booking services. This is because CRSs pass a proportion of the booking fee they receive from the airlines on to the agencies, when the agencies generate the booking. As a result CRSs compete for the business of travel agents by offering increasingly high 'cash-back' payments. However, these increased costs are effectively passed back to airlines in increased booking fees (which have been rising by around 5% per annum), so this form of competition is not effective in constraining CRSs' costs. For as long as the airlines are unable to exit from the upstream CRS market, they have no choice but to pay these higher booking fees.

In addition, and reinforcing the inability of airlines to exit from a particular CRS, some CRSs clearly have a very strong position in some national markets, which could be argued to yield a dominant position. This dominance could be due to an excellent service offering for the given market, built up from investment by the CRS over a number of years. Such dominance per se is not illegal.³ The CRSs that are smaller in each market do appear to compete for agency business. Agents that tender for their CRS business generate multiple participants which offer competitive bids. With evidence of this, it is difficult to argue that any individual CRS has the power to behave to an appreciable extent independently of its competitors and customers, since other CRSs appear to compete with them. Further detailed investigation of any particular national market may reveal that the generic picture of competitive tendering does not hold, in which case the incumbent may be shown to be dominant. In general, the conclusion is that any one CRS

² This is not referring to the constraints on parent carriers embodied in the Code. Here it is argued that even non-parent carriers could not defend a decision to leave a CRS on commercial grounds, because of the loss of business.

³ This assumes that the investment in the national services was not cross-subsidised by income from the airlines upstream.

is unlikely to be dominant in a downstream market; the goal is to harness these competitive forces to yield better outcomes for passengers and airlines.

Thus, CRS distribution is a joint product that offers services to both airlines and travel agents. CRSs do not compete for airlines to subscribe to their systems, but appear to compete vigorously between themselves for travel agents' business. This peculiar structure of the markets in which the CRSs operate has led to the following.

- Significant increases in the booking fees charged to airlines by the CRSs—on average 5% per year over the past five years. Although the cause of these price increases is unclear, the annual report of one of the CRSs mentions that the price increases were necessary due to higher costs of productivity booking schemes for travel agents.

The CRSs make relatively high profits.

- In the upstream market, the CRSs do not operate in a competitive environment, which may have led to inefficiencies in the CRSs.

- As the airlines provide the majority of CRS revenues, they effectively cover most of the CRS costs, and pay for most of the services provided by CRSs to travel agents, such as hardware and back-office software.

- The European and US markets for travel agents are largely saturated, which means that the vigorous competition among CRSs for travel agents is of no benefit to the airlines. It does not generate greater numbers of bookings, but results in better deals for the travel agents and therefore in higher fees per booking for the airlines.

- Travel agents are paid for each booking. This gives them an incentive to inflate the number of bookings they make—for example, with fictitious bookings or duplicating bookings made in one CRS in another CRS.

- CRSs may use the booking fees charged to the airlines to finance the cost of developing CRS services for other travel sectors, such as car rentals and hotels and more recently, e-business development (cross-subsidisation).

This does not preclude that CRSs may be found to be jointly dominant in any market, nor that particular actions on the part of an incumbent (for example, contractual terms that dissuade agents from switching) may be found to be anti-competitive. It could also be argued that the 'cash-back' schemes form an entry barrier into these downstream markets, since any new intermediary must give similar incentives to the agents.

- The high level of cash-backs offered by the CRSs to the travel agents may form a significant entry barrier for new firms attempting to offer competing services to the CRSs. It would be very difficult for a competitor to the CRSs to attract travel agents to use its system without offering the same rebates, or similar cash inducements. Given the overall costs of providing such inducements, any new entrant would need to use the same basic economic model as the existing CRSs.
- The productivity bookings have some characteristics similar to fidelity discounts. The volume discounts are structured to drive the marginal purchase towards the CRS, which limits effective competition from other sources (such as direct sales).
- Distribution costs are high due to relatively high CRS profits and possible inefficiencies in the CRSs. This reduces consumer welfare.

The problems with the current market dynamics, especially with respect to the upstream market, flow primarily from two sources: the market power of the CRS operators with respect to airlines; and the interaction between the upstream and downstream markets through the CRS operators. Thus, in economic terms, there are three types of remedy that could be used to address the problems identified in the upstream market:

- introduce changes in the upstream market that reduce or remove the market power of CRS systems with respect to airlines by enabling effective competition to operate between CRSs;
- introduce more effective regulation of CRS operators to directly counter their market power;
- introduce regulation that harnesses the competitive dynamic in the downstream market to counteract the market power in the upstream market.

In practice, the number of forms of remedy that could be pursued is limited. The three forms of remedy analysed in this report focus on:

- changing the Code of Conduct;
- monitoring the CRS cost base;
- altering the price arrangements to align incentives more closely.

Changing, or removing, the Code of Conduct is designed to make it easier for airlines to negotiate with the CRSs, and hence improve the balance of bargaining power between the two parties. The current obligations on airlines mean that parent carriers are faced with an imposed 'all-or-nothing' choice, inherently weakening their negotiating position with

each CRS.³ Relaxing the obligations on airlines to enable them to choose different levels of functionality, participation that differs across regions, or even the option to delist from a CRS if they do not like the terms they are being offered, may improve the commercial relationship between each airline and CRS.

However, altering the Code of Conduct so as to increase the freedom of carriers may not actually succeed in significantly altering the balance of power between airlines and CRSs. The CRSs may have strong individual market power over the airlines, as a result of their control of access to a significant proportion of the distribution chain. If so, changing or removing the Code to give airlines more potential freedom will not actually deliver significantly more freedom, and will not therefore alter the balance of power.

A second type of remedy is to encourage regulatory scrutiny of the CRS cost base. Regulation—in the sense of intervention by the application of rules on behaviour—would be used to redress directly the balance of power in the upstream market. The most extreme form would be full price regulation, with the regulator assessing the appropriate level of costs that should be borne by the airlines. Less intrusive options could include requiring CRSs to be more transparent about their costs. In all cases, the level of ongoing regulatory scrutiny of the industry is significant.

The third possible remedy would require the most significant change to industry practice. The key change would be that the bulk (if not all) of the charges for booking fees are paid to CRSs by *travel agents*, not airlines. In this remedy, the reservation fees are simply seen as another element in the cost of the inputs that a travel agent needs to deliver travel services. The travel agent procures these services directly, as with communications services, computing facilities, etc, and recovers the costs either directly from customers, or from the supplier of the service (eg, airlines or hotel operators), through a commission.

The key advantage from such a shift is the improved incentives. Agencies use the CRSs more efficiently as they bear the incidence of CRS costs. This has the potential to lower the number of speculative and fictitious bookings made. The current market structure, where travel agents strive to reach booking volume targets so that they can benefit from booking incentive arrangements, contains an in-built incentive to increase speculative and fictitious bookings.

Subscriber-based pricing also encourages travel agents to negotiate on price, as there is no direct cost pass-through. Travel agents would recover CRS costs from the airlines (or other travel-service suppliers) through the commission system. Airlines will pay travel agents a flat-fee commission per booking based on the average level of CRS charges. This provides an incentive for the travel agent to negotiate well with the CRS.

³ While only 'parent' carriers are obliged under the Code to offer the same level of functionality in all CRSs, contractual clauses effectively require 'non-parent' carriers to do the same (eg, Amadeus Participating Carrier Agreement, November 1999, Article 2 Clause 1).

If a travel agent negotiates successfully with its CRS provider, there is the opportunity to earn higher returns than its competitors by beating the average CRS charge 'yardstick' set by the airlines. This yardstick will be the portion of the overall commission that is intended to cover CRS costs. Similar yardstick incentive schemes are common in the regulation of the water sector and pharmaceutical reference pricing schemes.

The problems with introducing such a scheme include that it concentrates the sources of agency revenue into airlines' hands, increasing control by airlines of the distribution chain. This may not be welcomed by agents. As a remedy, it will only be successful if there is significant competitive constraint exerted by agents on CRSs. If any discrimination exists against small agencies, this will become more transparent in the new system, again provoking negative comment by agents. It is possible that some services of value to airlines may be underprovided if agents are now the key customer of CRSs. Hence, airlines will still need to contract with CRSs to develop new functions within the CRSs. Such side contracts may unwind the benefits of subscriber-based pricing.

The present market structure has become blocked. The CRSs have been able to shelter behind the Code of Conduct, refusing dialogue with the airlines, dismissing enquiries from the European Commission, and refusing to respect newly introduced provisions, such as those relating to group purchase of data, while at the same time building their businesses.

1. Introduction

The AEA has engaged GPC and OXERA to investigate the CRS economic model and the EU regulations that govern the relationships between airlines and CRSs. The objectives are:

- to identify options that would change the working model between airlines, agents and CRS service providers to facilitate better competition across functionality, quality and price, by introducing increased market forces or more effective regulation;
- to influence the EU in the short term to address some of the ongoing concerns about non-compliance with the Code and to improve the bargaining power of airlines with respect to CRSs.

This report shows that there are serious problems with the market structure, which result in perverse incentives. CRSs face no competitive constraints when dealing with airlines; CRSs do display competitive behaviour with regard to agents, but this competition focuses on increasing incentive payments, rather than delivering value-for-money services that benefit passengers. Two key remedies are proposed:

- enhance regulation to increase the scrutiny of the CRS cost base;
- impose subscriber-based pricing to harness the competitive elements of the agent-CRS relationship.

An action plan is outlined, explaining the first steps involved in turning the proposed remedies into politically feasible outcomes.

The report is structured as follows.

Section 2 begins with an overview of the sector under discussion, examining the main elements of the relationships between airlines and CRSs, and between CRSs and travel agencies. Section 3 then lays out the regulatory background and the history of the ongoing dispute between European airlines and the CRSs, and the involvement of the European regulator. Sections 4 and 5 describe the underlying economic behaviour in the existing system, explaining much of the observed undesirable elements as rational responses to the industry structure. The analysis uses a formal competition law framework to underpin the conclusions, which facilitates the later discussion of the options available for action.

Section 6 critically assesses the three proposed remedies:

- removing or altering the Code;
- increasing the scrutiny of cost (either through formal regulation, or increased transparency);
- mandating that travel agents must bear the costs of the booking fee.

The last two sections consider the political feasibility of the proposed remedies and outline a recommended plan of action to achieve each of the above goals.

The team endeavoured to interview the key players in every segment of the market, including CRSs and travel agents. Significant difficulties were encountered with gaining access, particularly to CRSs, and all parties were reticent in sharing commercially sensitive information, as would be expected. The document highlights where there is insufficient evidence to draw a definitive conclusion. In these cases, to take the analysis much further, powers of compulsion to reveal data would be required, and hence the recommendations include encouraging a competition authority to investigate the potentially problematic practices.

2. Market Characteristics

CRSs are involved in the business of travel distribution—they act as intermediaries between suppliers of travel services (airlines, hotels and car-rental companies) and distributors of such services (travel agents, Internet travel agents). The central role is one of information transfer, data are stored about current service providers and the CRSs provide the necessary infrastructure to transfer these data, facilitating the distribution of travel products between producers and travel mediators.

A CRS is a high-speed network which connects the system with the service providers (airlines, etc) on the one hand, and the travel agents on the other. CRSs obtain real-time information about flight schedules and seat availability from the internal systems of the air carriers⁶ and receive information on fares from ATPCo. ATPCo receives up-to-date information on fares several times a day from the air carriers—the list of fares includes both public and private fares (specific fares on which air carriers and travel agencies have agreed).

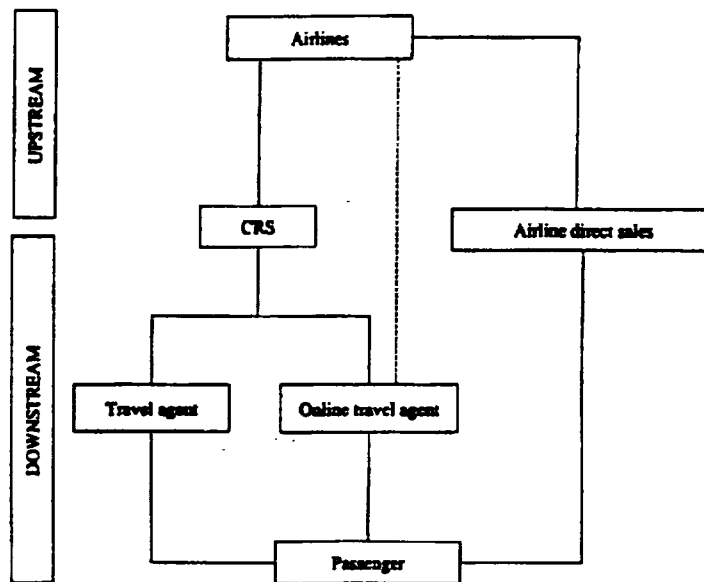
CRSs provide three basic functions: easy access to up-to-date and accurate information on flights and seat availability (search function); reservation (booking function); and fare quote and ticketing (ticketing function). Most CRSs also provide additional services, such as direct access to essential travel information and information about visa regulations and particular events. Furthermore, programs and interfaces have been developed which facilitate the internal administration for each travel agent. In addition, invoicing, accounting, customer and quota management are increasingly offered by CRSs.

2.1 Market structure—the upstream market

As Figure 2.1 illustrates, a CRS can be considered a distribution platform, which links airlines (upstream) and travel agents (downstream). In the upstream, or wholesale, market, the airlines provide the CRS with information on flight details, while the CRS offers airlines booking facilities and access to travel agents and travellers. Downstream, a retail market for the provision of air travel services exists. In this market, a CRS provides travel agencies with reservation, booking and ticketing services (and equipment, training and technical support).

⁶ Some airlines do not have their own internal reservation system. These airlines use a CRS for all their reservations.

Figure 2.1: Schematic representation of distribution of airline services

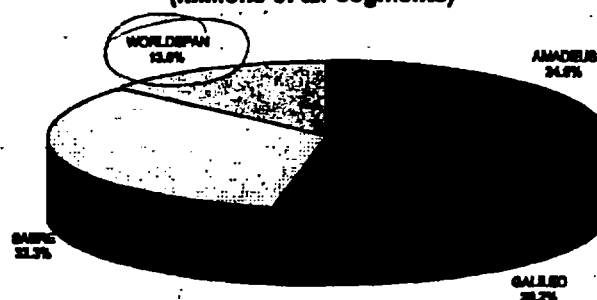


The CRS industry is dominated by four major companies: Sabre, Amadeus, Worldspan and Galileo. These grew out of the internal reservation systems developed by airlines from the early 1950s in the USA. Sabre was the first CRS to be developed, by IBM and American Airlines in the 1950s. It became operational in 1963, and was made available to travel agents in 1976. Other airlines responded to these developments by commissioning computer companies to develop similar systems, and the other main CRS companies evolved as the existing technology was modified and enhanced. Worldspan's roots lie in the IBM-based Programmed Airline Reservation System (PARS), initially developed in the 1960s before becoming the internal reservation system of TWA Airlines. While Galileo and Amadeus were founded by European airlines, their origins still lie in the CRS systems developed in the USA. Galileo developed out of the Apollo CRS initially introduced by United Airlines in 1971, while Amadeus was based on the software of the reservation system, System One, originally the CRS of Eastern Airlines.

Far-reaching changes have taken place over the last 10 years, with the flotation of Galileo and Sabre, but airlines remain majority holders in Amadeus and Worldspan. It is therefore instructive to look at the changing nature of CRS ownership over time.

The domination of the major four CRS companies can also be seen in the worldwide market share that each company commands.

Figure 2.2: Global distribution system market shares, 2000
(millions of air segments)



Source: Garrett Communications (2001), '2001 GDS Yearbook'.

There are also four regional CRS companies serving the far-eastern market: Abacus, Axess, Infini and Topas. A number of these are linked to one of the main CRS companies (see Table 2.1).

Table 2.1: Ownership of CRS companies in the Far East

Name	Area of operation	Ownership
Abacus	Asia/Pacific	Owned by Sabre and a consortium of Asian Airlines. Operates on Sabre platform
Axess	Japan	75% owned by Japan Airlines
Infini	Japan	Owned by Abacus and All Nippon Airways. Operates on Sabre platform
Topas	Korea	Joint venture between Amadeus and Korean Airlines

Source: OXERA, 2001.

While some airlines remain involved in the CRS companies, others have divested their stakes, and the CRSs have been floated on the equity markets. The most notable example of this occurred in 1997, when Sabre became partially publicly owned. This process was completed in 1999 when it was fully spun off from its parent carrier, American Airlines. Galileo International was also floated on the New York Stock Exchange in 1997, and on June 18th 2001 it was announced that Cendant Corporation would acquire the company for approximately \$2.9 billion.

Table 2.2: Ownership of CRS companies, 2001

Sabre	Galileo	Worldspan	Amadeus
100% publicly owned	74.4% publicly owned	40% Delta Airlines	30.08% publicly owned
	17.6% United Airlines	34% Northwest Airlines	23.36% Air France
	7.7% Swissair (sold in August 2001)	28% Trans World Airlines	18.28% Lufthansa Airlines
	1.5% five other airlines		18.28% Iberia Airlines

Source: Garrett Communications (2001), '2001 GDS Yearbook'.

The historical ownership of Amadeus and Galileo is reflected in the geographical spread of their revenue sources (see Table 2.3). While Sabre and Worldspan dominate the US

market, Amadeus takes the lion's share of European revenues. Galileo's revenues are the most evenly split among the CRSs.

Thus, it can be concluded that, far from being strictly a 'sub-industry' of the airlines, CRS companies are moving further toward self-sustaining, non-integrated organisations. Indeed, nearly 60% of travel agents now subscribe to CRS services controlled by the companies with broad public ownership.

Despite these ownership changes, there may remain a suspicion in the minds of regulators that parent carriers are likely to influence the CRS in which they hold equity in order to advance their operational interests, and hence that regulatory involvement to protect airline interests is unnecessary.

On the question of financial reward, parent carriers can easily show whether the incremental gains as shareholders outweigh the incremental costs as users of the systems. Non-parent carriers, which the Code of Conduct is designed to protect, are those that suffer most from the pricing system built into the current Code—they are subject to arbitrary fee increases, yet receive no shareholder benefits. In terms of allegations of bias, parent carriers in Europe would presumably accept that the non-discriminatory provisions of the Code of Conduct will continue to bind them, whether through a revised Code or by the application of competition policy. It is significant that the airlines themselves—including the parent carriers—object to the present market structure, although it may optimise profits for 'their' CRS. An airline shareholder will be as interested in the performance of the CRS as any other shareholder, but the European airlines concerned would argue that any benefits for the holding company from the present system are outweighed by the increasing costs of operations.

While airlines report that there is a clear arm's-length relationship between parent and CRS, which makes it difficult for an airline to exercise any influence, in the absence of formal ring-fencing, regulatory suspicions are likely to remain.

Table 2.3 presents the market shares (based on travel agency numbers) of the CRSs for broad regional markets. Each CRS is specialised in a particular region, with some very high individual market shares. Amadeus has a large market share in Europe; Galileo has a large market share in Canada, the Middle East and Africa; while Sabre is particularly strong in North, Central and South America and the Caribbean. Worldspan has a large market share in Mexico.

Table 2.3: Estimated worldwide travel agency locations of CRS vendors

	Amadeus (%)	Galileo (%)	Sabre (%)	Worldspan (%)	Total no. of travel agents
USA	12	27	40	21	45,374
Mexico	7	6	48	39	3,624
Canada	3	52	41	4	6,158
Caribbean and Latin America	45	11	43	1	14,929
Europe and Russia	52	22	15	11	63,076
Far East and Australia	15	17	67	1	38,696
Mid East and Africa	18	44	19	19	8,071

Note: This table overestimates market shares as it ignores other CRS and non-CRS travel agents.
Source: Garret Communication (2001), '2001 GDS Yearbook'.

Table 2.4 presents the market shares (based on travel agency numbers) of the different CRS vendors for the European market. Also within the European market, there is a high degree of specialisation. Amadeus has high market shares in Germany, France, Scandinavia and Spain, while Galileo has high market shares in the UK, Italy, Switzerland, Portugal and Ireland. Worldspan has a market share of 40% in Turkey. Sabre's market shares are relatively low—the highest is its share of 17% in the Belgian market.

The regional specialisation of the CRSs is due to historical reasons. For example, Amadeus was founded by a number of European airlines (among others Lufthansa, Air France and Iberia), based on the airlines' internal reservation systems. It was therefore attractive for European travel agents to subscribe to Amadeus, as it had very good access and understanding of the key European airlines. Sabre was in a similar position in the US market. Subsequently, CRSs have developed market-specific features through their national arms, in order to be more competitive in a particular national market. Different CRSs have focused their attention on different products and different areas. For example, in addition to air travel services, Amadeus and Sabre offer rail services in Germany and France, which give them a competitive advantage over Worldspan and Galileo in these areas.

Table 2.4: Estimated European-wide travel agency locations (%) of CRS vendors, 1995

	Amadeus	Galileo	Sabre	Worldspan	European share ¹
UK	7	73	15	5	18.7
Germany	82	10	5	3	15.5
France	80	7	8	5	14.4
Scandinavia	75	15	10		12.4
Italy	15	65	15	5	9.8
Spain	82	10	3	5	9.5
Switzerland	10	80	5	5	3.8
Netherlands	10	55	5	30	3.6
Greece	30	60	10		2.5
Turkey	20	40		40	2.5
Portugal	10	90			1.5
Ireland	10	82		8	1.5
Belgium	22	37	17	24	1.8
Other ²					4.9

Notes: ¹ The relative size of the national markets, expressed as a percentage of total scheduled air trips sold within each market.

Source: SH&E (1995), 'Study on CRS Charging Principles for the European Commission', July.

Flights can also be booked through other channels. Table 2.5 shows the proportion of sales of passenger-segment journeys sold through the various channels. The bulk of sales take place through CRSs. Only 22% of the tickets are sold over the telephone, airlines' own sales outlets or own Internet web sites (ie, channels that do not use CRSs).

Table 2.5: Upstream market concentration (%)

	Passenger-segment journey	Travel agents' locations
Amadeus	19.4	29.2
Galileo	22.0	22.9
Sabre	26.0	36.7
Worldspan	10.6	11.2
Others ¹	22.0	n.a.

Notes: ¹ The 'Others' category represents non-CRS sales and is extrapolated from 1995 figures. These older figures are likely to overestimate current non-CRS bookings—therefore the above are underestimates of CRS market shares. Travel agency proportions are overestimated, as they do not include non-automated agencies.

Source: Market shares of Amadeus, Galileo, Sabre and Worldspan: Garret Communications (2001), '2001 GDS Yearbook'; market shares of non-CRSs ('Others' category): SH&E Report (1995).

It can be concluded that most airline bookings are made through CRSs and that each CRS is specialised in a number of national markets. For example, Amadeus offers access to most of the travel agents (82%) in Germany, while Sabre gives access to 40% of the travel agents in the USA. Wherever a CRS is strong, it is the case that each CRS provides airlines with access to a large, discrete group of travel agents across the world.

2.2 Pricing structure in upstream market

The charging structures adopted by the CRSs are similar. Airlines are charged a booking fee whenever a reservation is made through that CRS system. The level of this fee depends on two factors: the country where the booking message originated,⁷ and the level of functionality in which the airlines participate.

CRSs offer different levels of functionality. As these levels increase, the CRS's ability to search schedules, check availability (eg, with seat maps), receive fare updates, etc, increases in sophistication. Levels of functionality can be viewed as a spectrum, with a basic booking request at one end, and full availability at the other. Generally speaking, the booking fee associated with the basic functionality is approximately half that associated with full functionality. Worldspan's 2001 pricing includes a \$1.88 booking fee for minimal service, and a \$3.26 fee for full service, while Sabre's prices ranged from \$1.98 to \$3.39 in the USA.

In addition to the above levels of functionality, airlines can choose to take optional services that can increase the booking fee still further. For example, Sabre's Carrier Specific Display product increases the full functionality fee by \$0.11 and allows a Sabre subscriber to request city-pair availability for a designated participating carrier. Sabre's Direct Connect service, which provides for instantaneous confirmation of seat assignments, is a further example of an optional service.

The final element of the typical CRS pricing structure is the cancellation fee, which is payable when a booking is made using a CRS and subsequently cancelled—in case of cancellation, the booking fee is refunded. Sabre's cancellation fee for 2001 ranges from \$0.11 to \$0.16 according to region.

The Code of Conduct demands that CRS pricing structures must be non-discriminatory, and charges are therefore the same for each participating carrier. As such, the airlines have no power (individually) to negotiate on price. While the Code in theory applies only to parent carriers, there is a 'parity provision' in all Participating Carrier Agreements, which requires any carrier active in a CRS to upgrade its participation in that CRS if it upgrades it in any other CRS for which it is a participating carrier. This effectively limits any carrier's ability to negotiate on price and service levels with any CRS.

2.3 The downstream market

The characteristics of the downstream market are very different from the upstream market. This section describes the services provided by the CRSs to the travel agents, the pricing structure, the level of switching and the various classes of travel agent.

⁷ Sabre's fees for a basic booking request, for example, are \$1.98 for a booking message originated in the USA, \$2.14 for a booking in Europe and \$2.41 for bookings in other regions.

As explained, CRSs provide various services to travel agents. The core product is the provision of a reservation system that allows the travel agent to investigate routings and seat availability with all the airlines supplying information to the CRS. In addition, the reservation system can provide a real-time booking engine (depending on the sophistication of the booking system of the airline in question), ticketing requirements, and information (and reservation capability) for a number of non-airline services, such as car hire or hotels.

Historically, CRSs have also provided travel agents with the hardware necessary to use their reservations systems. This was particularly important before desk-top computers were commonplace and cheap to purchase. CRSs would provide the terminals and connections that travel agents needed to access and interrogate the reservation system. These terminals and connections were CRS-specific, and a charge was made for them as part of the overall charge for the provision of CRS services.

The contracts were designed to take account of the fact that the agent was dependent on the CRS's hardware, allowing the CRS to gain a return on its investment, as well as remuneration for the provision of the reservation system. In addition, the CRS provided extensive training for staff members so that they understood how to use the CRS system that was characterised by abbreviated codes and symbols.

As technology has developed, travel agents have become less dependent on the CRSs for basic hardware, such as computers. It appears that, for a while during the late 1980s and early 1990s, the CRSs continued to offer hardware as well as the core service, but with fewer customers taking the full package.

The use of agents' own computers has also been facilitated by the shift from complex abbreviation and sign-based displays to those based on a graphical user interface (GUI). This is simpler to use, requires less training, and can generally be run from an ordinary desk-top computer using a software installation.

Accordingly, up to the mid-1990s, there had (in general) been a gradual reduction in agents' reliance on CRSs other than for reservation services. Recently, however, CRSs have expanded the range of services offered to travel agents to encompass the provision of networks and management information systems. They may also provide dedicated hardware (eg. ticket printers) to travel agents.

In order to provide the core reservation system service to travel agents, it is necessary for them to have a data link to the CRS computer server. For travel agents with more than one branch, the most efficient method of doing this is to have a single data feed into one of the agent's offices, and then connect all the offices to this main link. As a result, in order to provide the reservation system, the CRS creates a network running between all the agent's branches (if one did not previously exist).

Through these links, the CRSs offer network services as well as straightforward access to the reservation system to travel agents. Thus, smaller agency groups are supplied by the CRSs not only with their flight information, but also their communications infrastructure. It is not clear whether the larger agencies are also provided with such services, but the larger an agency chain, the more likely it is already to have an independent communications network between its branches. In such instances, a CRS would not duplicate the network, but branches would access the CRS through the single point of

connectivity, wherever that might be located, using the existing inter-branch links to reach it.

In some cases, CRSs have further integrated themselves into the operation of travel agents by providing management information, and, for some larger agents, full back- and mid-office systems. In this way, CRSs are heavily involved in the operation of their travel agent clients, and it is more difficult for the agents to switch between CRSs.

Therefore the level of involvement of CRSs in individual agencies varies considerably across the different types of agency. Summaries of the services provided to agencies by general grouping are provided below. This is meant as an indicative guide only, and would need further research with numerous travel agents to provide a more robust characterisation.

2.3.1 Segments of the travel agency sector

Although only limited discussions with travel agents have been possible at this stage, it appears that the travel agency market is segmented with respect to relationships with the CRSs. Below, the four key segments are discussed—full-service business travel agents, wholesale travel agents and consolidators, large leisure retail agents and small agents—focusing on the main elements of their arrangements with CRSs.

Full-service business travel agents

Only three full-service business travel agents have global reach: Hogg Robinson-BTI, Carlson Wagonlit and American Express Travel; consequently, they usually have global deals with the CRSs. In general, they will contract with several, if not all, of the major CRSs. The typical contract length is 3–5 years, and, at the stage of renewing the contract, the agent will obtain bids from all the CRSs.

Even the full-service agents normally only use one agent in a particular geographic region (normally at a country level, although the USA is more regionally based). The selection of the CRS that is used in each region is based on the regional strengths of the different CRSs. For example, in Germany the agents might use Amadeus, while in the UK it might be Galileo. However, these would be non-exclusive contracts in each region, and would not prohibit the agent from using a different CRSs if it had reason to do so—for instance, if a particular client wishes to use a specific CRS.

The strength of any particular CRS is often dependent on the additional services it can offer in a particular region, such as connections to local railway networks. It appears that, where a CRS has historically been the largest operator, it is also able to offer the broadest range of services to travel agents.

While full-service business agents are unlikely to need network services from the CRS, they may use the CRSs to provide back- and mid-office support, and management information systems. In such a situation, they would customise both their internal systems and those of the CRS, so that the two work seamlessly together.

The business agents may not have their own proprietary displays on their user terminals, but the CRSs are increasingly similar, so that only limited retraining may be necessary if the agent changed its CRS.

Wholesale travel agents and consolidators

The large wholesale travel agents and consolidators (for example, Trailfinders and e-bookers) are the most demanding with regard to CRS services, and correspondingly the most likely to switch between CRSs.

In general, the consolidators operate from a very limited number of large offices, thereby reducing the connectivity problems between them, and have developed their own proprietary front-end systems. They only use the CRSs for their core functionality—the reservation system.

If they were to change CRS, this would occur as a change in the input to their system, but the terminal operator would not notice, and probably not even be aware of, any difference (assuming the same level of functionality between the old and new CRS). The main problems with switching CRS are the interconnection between the new CRS and the in-house system, and the migration of bookings (discussed in greater detail below).

As consolidators have a considerable level of demand, and it is relatively straightforward for them to change CRS, they are able to obtain good terms in the market. There is also clear evidence that they will switch between CRSs if necessary, with one consolidator changing CRS five times in three years.¹

Large leisure retail travel agents

These are the large retail chains that mainly focus on package holidays, but also sell scheduled flights when requested by customers. It is not clear at present to what extent large retail travel agents use CRS services.

It is likely, however, that such agents do not use the CRSs' network services, nor, possibly, their back- and mid-office solutions. These functions are already likely to be in place to support the package-tour sales operation that accounts for the majority of large leisure retail agents' business.

Small business and leisure travel agents

Regardless of whether they deal with leisure or business travel, it is likely that small travel agents have similar requirements and usage of the CRSs. Such agents are less likely to have an existing network, and so will use the network service packages provided by their CRS. However, due to their small scale, they are unlikely to need sophisticated support services or management information systems.

Small travel agents will therefore use the core reservation systems provided by the CRSs, and will take the opportunity to have a communications network included in the package. They may also require more hardware than the other types of travel agent.

¹ Information provided to the team during an interview.

2.3.2 Pricing structure in downstream market

Prices between the CRS and travel agents are determined through individual negotiation, although the overall structure of the charges appears largely the same across agents.

Prices are set on either a net or gross basis. The net fee adjusts the per-booking payment from the CRS for the unit charge for hardware and other CRS services (eg, network provision) used by the agency. This unit charge is estimated from the total price for the additional services and the expected number of bookings. The gross fee is effectively an unbundled version of the net basis. The per-booking fee is not adjusted, and the agency is charged separately for the other services, which gives the agency more control over its costs, and allows transparency of the charging regime. The risks differ across the two methods, with a benefit from the gross arrangement if booking numbers exceed expectations.⁹

If an agency uses the unbundled pricing basis, it is more certain of paying the CRS appropriate charges for the hardware, software and other peripheral elements it chooses to accept from the CRS. However, it is not clear at present whether the fee levels available on the gross booking fee basis are equivalent to the net booking fee charges, nor whether the same incentive structures (see below) are used.

It is also not clear whether all agents are offered the choice of net or gross fees, or even whether all CRSs offer these fee bases.

The reason the CRS can afford to pay the agent (rather than the agent paying the CRS for receiving a service, as is found in more conventional markets) is that the agent effectively creates revenue for the CRS. By booking through a particular CRS, the agent allows the CRS to charge the airline its booking fee, which will be higher than the agreed payment to the travel agent.

As the booking fee paid by the airline is a flat-unit rate, regardless of the number or type of bookings the agent executes, the CRS has an incentive to increase the aggregate number of bookings that are transacted through its system. Accordingly, CRSs compete with each other to maximise the number of bookings through their own system. This has resulted in interesting incentive arrangements, known as 'productivity payments', or 'cash-back', from the CRS to the agent.

These incentive payments are basically loyalty bonuses. When the contracts are negotiated, the agent specifies its expected number of bookings in the relevant time period (usually on an annual basis), and the CRS quotes a booking rebate on the basis of this figure. The CRS will offer larger per-booking rebates to the agent, the greater the

⁹ For example, consider that an agent with 400,000 expected bookings per year has the option of a net fee of £1 per booking, a gross fee of £2 per booking, with annual fixed charges of £450,000. If bookings are in line with expectations, the net booking fee provides a better return. If, however, actual bookings are 500,000, the agent receives £500,000 on the net fee basis, but £550,000 from the gross fee.

number of bookings that it commits to put through that CRS. The CRS may use the opportunity of higher per-booking rebates to encourage the agent to commit to produce very high levels of bookings in any one year.

Most of the CRSs agree a flat per-booking rebate that applies to all bookings by the agent, but with penalty elements if the agreed total is not reached. The agent is charged for the shortfall in the number of bookings below the target, and this per-booking charge generally exceeds the value of the rebate from the CRS. For example, OXERA found evidence of a CRS tariff that offered a £1 rebate per booking, with a penalty charge of £1.50 per booking below the target.

As a result of the incentive structures used, most travel agents use only one CRS in any geographic region. If an agent contracted with more than one CRS, the volume spread across each CRS would be reduced, and the per-booking fee payments would be smaller. The exceptions to this rule are mainly due to legacy systems post-consolidation. Another exception is the larger business travel agents, which may contract with all the CRSs so that they can satisfy large corporate clients with a preference of one CRS over another. None the less, these agents often have a preferred CRS through which they transact the majority of their business.

2.3.3 Contract length

The Code of Conduct restricts the contract length for CRS services to a maximum of one year with termination penalties, and thereafter both parties to the contract must be able to withdraw at three months' notice.

However the Code does not make any reference to hardware or peripheral services provided by the CRSs. The contracts for these are separate from the main CRS contracts, and are considerably longer, possibly with termination penalties. For example, hardware contracts (printers, terminals) may be for between 3 and 5 years. In addition, there will be termination charges to compensate the CRS for a loss of return on its hardware investment.

These terms are often found in equipment-lease contracts, where one party to the contract makes an investment in order to provide the services or equipment to the other party (in this case, the CRS bears the hardware investment). However, the impact on the CRS-travel agency market is that it effectively (although not explicitly) increases the length of the CRS reservation system contract.

In other words, although the agent is free to terminate the reservation service contract while maintaining the hardware contract, in practice this is difficult, and involves managing two contracts rather than one. It is also not clear whether there is pressure from CRSs to retain a link between the two types of contract (this could be an anti-competitive tying practice, for which there is currently no evidence).

Therefore, the effect of CRSs offering a broader range of services to travel agents that are contracted for a period of more than one year is also to extend the effective length of the contracts for reservation systems.

2.3.4 Travel agent switching between CRSs

The level of switching by travel agents between CRSs is unclear. It appears to vary between the different types of agency. As noted above, the wholesale and consolidator

agencies appear to be the most likely to switch CRS, and have structured their internal systems precisely in order to do so. For other agencies, however, switching appears to be less easy.

Smaller agencies appear to have particular problems in switching. If they take a considerable amount of non-reservation system services, such as communications network provision, they become heavily dependent on the CRS. Changing the CRS could involve considerable upheaval in the business, and would not be undertaken lightly. Furthermore, small agents with lower trading volumes are less likely to be offered deals that are as good as those offered to the larger agents, or even provided with the inducements to switch that are given to the high-volume firms.

One of the main potential problems of switching CRSs in terms of bookings is control over existing bookings. The migration of the current database to a new CRS can be difficult, and a time-consuming process. The CRS is likely to be the main source of information for the travel agent about their outstanding bookings, and traveller data. If this information were lost in the migration from one CRS to another, it would be extremely difficult to recover, and customers may not receive their tickets or flight confirmations.

Steps must be taken by the agent to mitigate the migration problem. Often, this will involve making hard copies of the database of bookings, and passenger details. The degree to which the CRSs will facilitate the migration process is unclear, and reports conflict between different agents. It may be that the level of involvement, particularly from the new CRS, is dependent on the importance of the individual client, and the greater the expected volume of business, the more effort the CRS will make in helping the migration process.

While there is clear competition between the CRSs for agency business, there appears to be a significant incumbent advantage, indicating that the existing CRS is likely to retain the business. The reluctance of agents to switch is increased by greater costs of switching, such as may arise from longer hardware contracts, with termination charges, and problems with migration.

It should also be noted that, in spite of the fact that, for some travel agents, switching is relatively easy, the level of actual switching is probably low. This is because the incumbent CRS will often match or beat the 'cash-back' schemes offered to its travel agents by one of the other CRSs, thereby removing the travel agent's incentive to switch.

3. Background/History

3.1 General background to the Code of Conduct

The Council adopted the Code of Conduct Regulation on July 24th 1989, as part of the package on air transport liberalisation within the EU. The motivation for the Code was to promote fair competition in the airline sector (ie, competition *between* airlines for passengers). The EU wanted to ensure that large airlines did not use their ownership of CRSs to promote and protect their own interests, by preferential bookings on parent carrier flights, or by raising barriers to entry for market entrants. The Regulation was covered by a block exemption (3976/87, and later by 3652/93) (see section 3.2).

In 1993, the Code was modified to ensure equal functionality between participating carriers and to oblige parent carriers to provide information to all CRSs. In a major part this was intended to ensure that there was fair competition *between* CRSs and it was intended that equal access to flight and pricing information would benefit travel agents, air carriers and, ultimately, consumers. The block exemption expired on June 30th 1998.

The Code was changed again in 1999 to place a greater responsibility on subscribers (travel agents), with the introduction of Annex II. The Annex was introduced in order to ensure that subscribers would not provide 'inaccurate, misleading or discriminatory' reservation services. It was also intended to prevent travel agents making speculative or fictitious bookings in order to maximise the incentives offered by suppliers. Finally, the Code was extended to cover rail bookings.

3.2 Legal position

The Code remains embedded in Council Regulation 2299/89 (323/99 is the most recent amendment) and the Commission must formally propose any changes for modification of the Code. Any modifications would almost certainly be adopted by the co-decision procedure, as a joint Regulation of the Council of Ministers and the European Parliament.

The Commission's 1997 report and proposal for amending the Regulation (COM(97) 246 final) called for a review by the end of 2002. However, this provision was not incorporated in the final text as adopted by the Council, and is therefore missing in the final legislation; no reviews are currently scheduled.

Furthermore, the block exemption granted under the original Regulation has lapsed, meaning that Article 81, paragraph 1 is now directly applicable to the common purchase, development and operation of CRSs. In other words, CRSs are liable to the full scope of competition rules and cannot prevent, restrict or distort competition by:

- (a) Fixing purchase or selling prices;
 - (b) Limiting or controlling production, markets, technical development or investment;
 - (c) Sharing markets or sources of supply; or
 - (d) Applying dissimilar conditions to equivalent transactions with other trading parties, placing them at a competitive disadvantage
- unless there are deemed to be compensating benefits.

One aspect of the Code has been challenged in the European Court. In December 2000, the Court of First Instance ruled on the Galileo/Amadeus complaint against Article 6.1b part v—data processing for a common enterprise (case number T-113/99). The Court

heard testimony from the CRSs that they represent a 'closed category, distinct from any other company which might in the future run a global CRS within the Community'. Furthermore, the CRSs claimed that they represent a 'restricted circle of operators targeted by the contested (Code) provisions'. As such, they complained that the Code had a direct effect on their business and stressed the existence of barriers to entry as proof of their unique nature.

The Court of First Instance rejected the CRS argument that the provisions were unacceptable because they targeted specific parties. However, it is none the less significant that the CRSs should have seen themselves as a closed circle in this way.

3.4 Exchange of letters with the Commission

The airlines' concerns about the operation of the Code since the 1999 amendments have been expressed in a series of letters to DG TREN. The most significant of these is from the AEA to Michel Ayrat, DG TREN's Director of Air Transport, dated March 15th 2001.

This letter suggests that there has been collusion between the CRSs on the timing and procedure for price changes, and that the increases are 'neither reasonably related to costs for services offered and used by the airlines nor are they plausible regarding the actual development costs for computer operations'. The letter also claims that 'the airlines earlier had tried to challenge or to negotiate those increases and were threatened by the CRSs to be cut off the system.'

Sørensen replied on behalf of Mr Ayrat on April 10th 2001. Among the key points in the Commission reply are the following:

- the Commission is happy to investigate the complaint, but requires further information;
- if problems are arising which can only be resolved by changing the Regulation 'then such improvements must certainly be considered and appropriate legislation proposed if necessary';
- a significant number of carriers firmly remain parent carriers, with 'a serious financial interest in ensuring that CRSs are as profitable as possible';
- there will be little scope for relaxation of the basic principles as long as there are parent carriers;
- a revolution in technology since the drafting of the Code will offer new possibilities for airlines to bypass CRSs.

This exchange of letters was the culmination of a flow of correspondence which included the problem of fictitious booking and the CRSs' refusal to recognise the entitlement of 'group' applicants to collective purchase of Marketing Information Data, as set out in the 1999 amendment.

3.5 The US regulatory regime

A major difference in policy approach towards CRSs between the USA and the EU is apparent. In the USA, CRS regulation is centred on airline ownership issues. While some CRSs (Sabre) no longer have any links to airlines, it appears that US policymakers will continue to apply the CRS regulation. Within the EU, however, CRS regulation has a

basis in functionality, so that every product relating in any way to air transportation is covered by the Code.

The US rules were reviewed in 1997 to take account of parity provision, so that levels of airline participation may differ across CRSs. On reviewing CRS legislation, the US Department of Justice (DoJ) noted that:

unless a carrier is willing to forego access to ... travel agents, it must participate in every CRS' and observed 'more than three-quarters of CRS revenue is earned from airlines which see little price competition among the CRSs while approximately ten percent comes from travel agents which see intense price competition.'⁴⁰

Following a letter from the Chair of the Senate Commerce Committee (Ernest Hollings, D-SC) to the Secretary of Transportation, Norman Mineta, the Department of Transportation is currently reviewing CRS legislation to produce a revised set of rules. While no official deadline for the revised legislation is in place, it is understood that a new set of rules could be discussed by the end of 2001. Officials within the Department of Transportation stress that, while the EU has asked for US rules to become more similar to its own, it appears that there are no specific plans to do so.

Senate sources say that the new rules are likely to focus on the issue of Internet alternatives to CRSs, fidelity payments and the impact of e-commerce on the market, rather than on the structure of pricing. Just as with EU policymakers, there appears to be a strongly held belief that the Internet will provide a good source of competition for the CRS market. However, the most fundamental issue for US policymakers remains the belief that there is still no clear distinction between the airlines and CRSs. As such, it appears unlikely that there will be a significant reshaping of the current regulatory framework.

The exception to the US CRS system is shown by Southwest Airlines, which participates only to a limited level in Sabre. Because the airline operates on a point-to-point system—rather than a hub-and-spoke approach (ie, there is no reliance on connecting flights)—and operates in dense markets, it has been able to build strong name recognition and rely on direct sales rather than participating in normal CRS services. At present, for example, it is estimated that the Southwest Airlines' web site accounts for 35–40% of total sales. However, it should also be noted that the Southwest formula is an extension of its unique business organisation, and as such is not suited to most airlines.

3.6 Cendant-Galileo

In a recent development, the US service company, Cendant, received EU and US regulatory clearance for its acquisition of Galileo International following an agreed offer. Cendant also owns Avis and several hotel chains, which gave rise to concerns that the

⁴⁰ of the US Department of Justice to the US Department of Transportation, September 19 1996. Docket

deal could allow Cendant to introduce 'screen-based bias', where Cendant's businesses would gain an advantage over others. The Commission considered this issue, but determined that CRSs are a minority supply route for car rental (the main potential problem area), and therefore no further action was necessary.

The airlines expressed concern about potential cross-subsidy of non-airline product developments by airline booking fees. This means that airline fees may be used as the source of funds to support other aspects of their business (such as rail, car and hotel reservations). However, the Commission did not consider this to be a significant complaint and no action was taken.

Nonetheless, these developments further suggest that the Code with its detailed rules constraining only airline behaviour is no longer appropriate to the marketplace that is evolving.

3.7 Relationship between airlines and CRSs—chief complaints

As the patterns of CRS ownership and control have changed over the past decade, so, too, has the relationship between airlines and CRS organisations. Indeed, in many ways, relations between the two groups have become more strained with changing market dynamics—the clear result of an industry that is operating under an outmoded regulatory structure.

Currently, the chief complaints against CRSs by the airlines are:

- *level of fees*—fees to carriers are increased on a regular basis, despite the fact the computer-processing costs have generally declined over the last ten years;
- *a lack of transparency in fee fixing*—there is no system in place to verify that CRS fees are indeed based on cost, and the CRS organisations themselves have consistently refused to share this information voluntarily;
- *CRS refusal to negotiate or explain behaviour*—in general, there is a lack of willingness on behalf of the CRS companies to address serious airline concerns in a forthright manner. This has been the experience of the AEA;
- *refusal to acknowledge same-day cancellations* in the net figure charged to airlines. Some CRSs insist on charging a fee for same-day cancellations, although the Code provides that cancellations should not be chargeable. Cancellations on day of departure account for 4–9% of booking volume, depending on the airline;
- *travel agent discipline*—there is insufficient CRS monitoring of travel agents as regards duplicate booking, overbooking and other activities disallowed under the Code;
- *active/passive booking practices*—this is particularly a problem in Germany, where two CRSs may be involved in a single booking, generating double charges for the airline;
- *group provision for data purchasing has not been applied*—the possibility for 'a group of airlines and/or subscribers' to purchase data for common processing has never been accepted by any of the CRSs; and
- *airline fees cover travel agent incentives*, which the airlines see as a marketing cost, rather than an operational cost, and therefore should not be charged back under the Code.

The European Commission has referred some of these points to the CRSs. The responses have been:

- some changes in the charging system are not price increases but restructuring measures that are revenue-neutral to the CRSs;
- changes have been made to ensure that only *ticketed* passive bookings are charged to the airlines;
- CRSs are entitled to recover their costs through increased fees and EU rules do not 'determine or limit the number of price changes a CRS can have'; and
- net booking charges cover many other services provided to the airlines distinct from actual reservations.

The AEA and associated airlines have made several attempts to bring these concerns—and the systemic issues underlying them—to the Commission's attention. Despite these efforts, there are no plans at present either to conduct a full review of the CRS Code, or to introduce other measures to rebalance the system appropriately.

4. Defining the Markets and Assessing Market Power

Against the industry and regulatory background laid out in sections 2 and 3, the aim is now to set these industry features within a standard competition law framework. By defining the market structure and more formally exploring the market power of the participants, a coherent analysis of the CRSs' actions is possible. More importantly, the likely success of a given remedy can be assessed against whether it addresses the underlying market problem.

The market under analysis is complex. The underlying driver of the market is the service being supplied to passengers by air travel suppliers—CRSs and travel agents are both intermediaries in this exchange. In many markets, intermediaries are considered to be eminently substitutable, and hence draw little attention from competition authorities. However, the nature of the intermediary CRS does lead to concerns about the competitiveness of the market. From the airlines' perspective, CRSs are not readily substitutable for one another, as each CRS controls access to an important share of passengers through its member travel agents. Additionally, there are significant barriers to entry into CRS supply, which means that new intermediaries are rare. Thus it is important to focus on the relationship of the intermediary CRS in its encounters with airlines and agents.

This role that the CRS plays between airlines and agents means that two markets are focused on:

- an *upstream market* for the distribution of airline information and reservation services for air travel to travel agents and system users; and
- a *downstream market* for the provision of information, booking and ticketing services for air travel services to agents.

These markets are discussed in full in section 4.1.

Having defined the two markets, the next stage is to consider the power of the CRSs within these markets. It is a crucial element of this to recognise the interdependency of the two, as reflected in the fact that CRSs are intermediaries.

CRSs have significant market power over airlines because each controls a large proportion of travel agents in the downstream market. It is argued that the conditions are not in place that would prevent any one CRS (and certainly the four taken together) behaving independently of its customer airlines. This independence is revealed by the fact that most airlines could not choose to cease to participate in any one of the four major CRSs, regardless of the contractual terms offered.¹¹

¹¹ This is not referring to the constraints on parent carriers embodied in the Code. Here it is argued that even non-parent carriers could not defend a decision to leave a CRS on commercial grounds, because of the loss of business.

In general, many intermediaries appear to control access to customers in this way, but do not cause serious competition concerns. In other industries, suppliers can generally vary the prices they charge by delivery channel, to influence end-customer behaviour. Giving end-customers an incentive to pick one channel over another then gives the supplier influence over the channel itself. Airlines are legally constrained in their ability directly to influence travel agents' choice of CRS, or to use indirect methods, such as offering different fares to different CRSs, through the Code and other regulatory rules. Hence they have no lever by which to affect any given travel agent's choice of reservation system.

In the downstream market, competition by CRSs for travel agency market share is observed, as would be expected. There appear to be two main components of a CRS's offer to an agency—the extent to which the CRS is tailored to the needs of the agent's main market, and the price of the service offered. However, the price element of that competition takes a perverse form. Whereas five years ago there were still a number of agencies paying CRSs for services, now most agencies seem to receive payments from CRSs, as well as receiving the booking services. This is because CRSs pass a proportion of the booking fee they receive from the airlines on to the agencies when the agencies generate the booking. As a result CRSs compete for the business of travel agents by offering increasingly high 'cash-back' payments. However, these increased costs are effectively passed back to airlines in increased booking fees (which have been rising by around 5% per annum), so this form of competition is not effective in constraining CRSs' costs. For as long as the airlines are unable to exit the upstream CRS market, they have no choice but to pay these higher booking fees.

In addition, and reinforcing the inability of airlines to exit from a particular CRS, it could also be argued that some CRSs have a dominant position downstream in a given national market. This dominance could be due to an excellent service offering for the given market, built up from investment by the CRS over a number of years. Such dominance per se is not illegal.¹² It could be argued that the 'cash-back' schemes form an entry barrier into these downstream markets, since any new intermediary must give similar incentives to the agents. This may strengthen the position of any incumbent player. These arguments are explored in full in section 4.2.

4.1 Definition of the market

When assessing market power, a restrictive agreement or possibly abusive conduct under the competition law, competition authorities generally have to define the 'relevant market' in which the merger, agreement or conduct takes place. Defining the relevant market is not an end in itself, but rather a very important, intermediate step in evaluating the competitive constraints faced by the company or companies subject to the investigation.

¹² This assumes that the investment in the national services was not cross-subsidised by income from the airlines upstream.

Usually a distinction is made between two types of competitive constraints that could prevent a supplier of a certain product in a certain geographic area from increasing its price.¹³

- *demand-side substitution*—customers may switch to other available products or to other geographic areas; and
- *supply-side substitution*—companies already supplying similar products (or neighbouring geographic areas) may readily switch to supplying the product (or area) of the company in question.

The following sub-sections demonstrate that there are two distinct markets involving CRSs:

- a wholesale market for the distribution of information and reservation services for air travel through CRSs and other booking methods, which is global in scope; and
- a retail market for the provision of air travel services (including information, booking and ticketing) to travel agents through CRSs and other booking methods, which is national in scope.

These could be argued to be conservative definitions of the markets at issue—in particular by including all other booking methods—and would therefore understate the degree of market power currently enjoyed by the CRSs.

The geographic elements of the defined markets match the internal corporate structures of CRSs. All arrangements with airlines are coordinated on a global level, while dealings with agents are delegated to national marketing bodies. This latter structure allows CRSs to respond to the different needs of national travellers.

4.1.1 Defining the upstream market

In the upstream market, airlines need to disseminate information on scheduled airline flights, and give access to passengers for booking these services. Travel agents are the key link in this chain between passengers and airlines, although most airlines also have direct sales. From an airline perspective, the important issue is access to consumers who purchase scheduled air tickets, whether this is through a travel agent or a direct transaction with the consumer. The CRSs are a crucial input into the travel agents' business of supplying travel advice and sales to consumers, and the service that CRSs (through travel agents) are providing for the airlines is this access to consumers.

The methods for delivering information about scheduled airfares to consumers can be separated between CRS services and other sales routes, such as direct sales or Internet sales. These information distribution and sales routes have different characteristics, and

¹³ A third constraint, that of completely new entry, is considered when assessing market power in the defined market.

offer alternative methods of supplying consumers with the same service. The question is whether all of these providers should be seen as part of the same market.

The answer to this question may differ, depending on whether the time frame being considered is the short run, or whether longer-run bypass options are included.

Potential short-run substitution away from any CRS

The degree to which an airline can substitute away from any of the CRSs is very limited in the short run. This conclusion depends crucially on the characteristics of the downstream market. Individual CRSs are not substitutable for as long as each one provides exclusive access to a number of travel agents and, through them, exclusive access to particular (potential) passengers. If travel agents changed CRSs readily, and in response to the inclusion or absence of a particular airline in the database, or potential passengers switched travel agents on the basis of the characteristics (ie, whether or not a particular airline was included in the data base) of the CRS used by the travel agent, different CRSs would be substitutes for airlines. However, if the downstream switching does not take place (and quickly) then, from the airline's perspective, the CRSs are not substitutes for each other and each CRS would be in a separate market.

Thus it is necessary to understand the extent to which travel agents consider CRSs substitutes, the number of CRSs to which travel agents subscribe simultaneously, and whether agents can easily switch from one CRS to another. For example, if most travel agents used more than one CRS simultaneously, and could switch between CRSs with ease, airlines would have a choice over which CRS they used to access any particular agent.

It appears, as described in section 2, that most travel agents use only one CRS at any one time, a phenomenon facilitated by the incentive payment structure.¹⁴ The main exception to this rule is the large business travel operators, but even they usually have one preferred CRS in any given country.¹⁵ This means that if an airline discontinues its participation in one of the CRSs then, at least in the short term, it risks losing the business of all the travel agents supplied by that particular CRS.

The proportion of agents to which access would be lost in the medium term as a result of withdrawing from one CRS will depend on the ability of travel agents to switch to the other CRSs (assuming the airline participates in the other CRSs). If switching in the downstream market were relative easy, and travel agents were motivated to switch on the basis of the airline membership of a CRS, then this would give airlines more leverage over CRSs in the upstream market, and would suggest that the CRSs are substitutes.

¹⁴ Data provided by British Airways indicates that only 1% of the UK travel agents that book flights with British Airways use more than one CRS.

¹⁵ The USA may be the exception to this.

As explained in section 2, the possibility of switching even in the medium term may vary for the different types of travel agency. Certain classes of travel agencies and passengers can switch, while others are more constrained. The switchers consists of large companies, consolidators, tour operators and large business travel agencies. Small and medium-sized travel agencies often use network, hardware and software provided by the CRS, which makes it more difficult to switch.

Furthermore, although, to a large extent, the CRSs all offer a similar level of service, there are differences that may affect travel agents' willingness to switch between CRSs. In a number of national markets, some CRSs have a competitive advantage over others. For example, Amadeus and Sabre provide travel agents in Germany and France with national rail services that are considered essential services from a CRS. This explains to some extent why travel agents in these countries do not easily switch to Galileo or Worldspan unless they are adequately compensated.

Finally, even if travel agents quickly switched CRS as a result of an individual airline exiting the data base, this may not give airlines as a class much more power in the upstream market. This is because, if different airlines exited different CRSs, the pressures on travel agents to switch CRS would tend to cancel out. Thus, even if switching were easy, airlines would still face pressures to join all CRSs.

At present the level of switching seems to be relatively low, with the exception of the large consolidators. However, it is not clear whether this is due to an actual differentiation between the CRSs that means that they are not substitutes, or merely an incumbent advantage in retaining agents at the renegotiation stage. In particular, the incentive schemes may distort the true assessment of substitutability. Even so, the rate at which the incentive payments have escalated in recent years suggests that there is some competition between CRSs, and that switching is feasible.

In the short term, it is likely that airlines have no option but to participate in all CRSs. The current market suggests that CRSs provide access to a fixed block of travel agents that are unlikely to be influenced to change CRS by the action of an airline. Hence, it could be concluded that, in the upstream market, each CRS forms a separate market, from the perspective of a major carrier.

Options for bypass of CRS with other booking methods (direct sales and Internet)
In the medium term, other booking methods, such as direct sales and Internet-based travel agents, may be considered substitutes for CRSs. Currently, OXERA is not aware of any Internet site that has direct contacts with airlines, but still provides the same route and fare comparison provided by a CRS-based site. However, as these services develop, they may undermine the position of the existing CRSs. This depends predominantly on whether travel agents consider these other booking methods substitutes for a CRS-based service, and whether consumers consider them to be a substitute to travel agency services.

Internet travel web sites are one suggested bypass route for disintermediation. As far as passenger choices are concerned, customers may go directly to their favourite supplier for a repeat journey about which they are already fairly well informed. Where the routing is straightforward, and price is the principal concern, direct sales are also a popular booking method. For example, airlines offering cheap tickets, such as EasyJet and Buzz, do not participate in any CRSs and their flights are not sold through travel agents.

Similarly, for routes with a limited number of carriers, especially domestic flights, passengers may also avoid using travel agents. In both the USA and Europe, the number of direct sales is particularly high for domestic flights.

At present the services that actually bypass a CRS are limited, and mainly constitute airline direct sales. In 1995, around 20% of bookings were direct sales and this approximate proportion is confirmed by some individual carriers.¹⁶ The remaining 80% are through travel agents, predominantly through the four major CRSs.

As the complexity, or unusualness, of the routing increases, the probability of using a travel agent (and hence a CRS) increases, as it is a very efficient means of comparing options. This would imply that the 20% of journeys that are already avoiding CRSs form a separate market because they comprise journeys that do not require the passenger or agent to search widely for options.

Alternatively, this 20% could act as a constraint on CRSs, indicating a longer-run scenario in which passengers substitute away from CRSs to new, disintermediated, direct options.

Geographic scope

The geographic scope of the wholesale market is global. On the demand side, this is because the Code prevents an airline from only using a CRS for a restricted regional area—if an airline participates in a CRS, its flights can be booked by all the travel agents in the world subscribing to that particular CRS. On the supply side, because the market is predominantly about the supply of information, once a CRS has the information, it can supply this to all its travel agencies at limited additional cost. One of the key additional costs will be the physical infrastructure linking a new region to the CRS. This is unlikely to be a costly exercise in most parts of the world. Hence, the supply-side characteristics are also suggestive of a global market at this wholesale level.

Conclusion

In the short run, it appears that major airlines have little choice but to participate in all four CRSs because each controls a significant proportion of world demand for air travel. Formal critical loss tests have not been conducted, but the likely margin on an extra sale as compared with the cost of the booking fee should show that it would be highly unprofitable for an airline to cease participating in any CRS. This indicates that the upstream market boundaries could be drawn very narrowly, arguing that each of the four CRSs is in a separate market. The medium to longer term is more relevant for the regulator, who may be reticent to intervene if market forces (even if slow-moving) are likely to address the concerns over time. There is evidence that switching between CRSs is feasible for travel agents, suggesting that airlines do in theory have the option to choose

¹⁶ Drawn from material provided in response to the team's questionnaire.

the CRSs in which they participate.¹⁷ In addition, there is some evidence that consumers are willing to use direct sales for certain types of travel bookings. These direct sales already form 20% of bookings and some commentators expect them to grow markedly.

Thus, conservatively, the market is defined to include the distribution of information and sales booking services for scheduled airline seats by CRSs and other sales methods on a global basis. This implies that airlines can use these bypass methods, over a long period of time, to constrain the behaviour of the CRSs.

4.1.2 Defining the downstream market

Travel agents need to provide their customers with information about scheduled air services, and have a method of booking and ticketing selected flights on behalf of the consumer. The only automated method of carrying out the search element of this process is a CRS—agents could phone all airlines operating on a particular route, but that would be laborious, and was exactly the system that CRSs were introduced to replace. CRSs compete in providing information and booking services to travel agents (both traditional and Internet-based); they do not provide these services directly to consumers.

In determining the extent of this market, the key issues are very similar to those already considered in relation to the upstream market. How easily can agents switch between different CRSs and to what extent can an agent completely bypass the CRS system?

Substitution between CRSs

As already noted above, most agencies have only one CRS, and even global agencies generally have a single main CRS in each geographic region. This is mainly as a result of the incentive payments (and penalties) imposed by the CRSs that reward the agencies for maximising the number of enquiries and sales through any one CRS (and charge them for failing to meet the pre-agreed targets).

The degree of switching varies according to agency type, both in terms of the feasibility of switching, and the gain from engaging in it. For example, consolidators make very little use of the bespoke elements of the CRS, making switching technically straightforward; also, as they generally deal solely in tickets (and usually at the low-price end of the market), they have a strong incentive to reduce all intermediary costs. Regardless of the amount of switching observed in the market, the steady increases in the incentive payments provided to the agents is *prima facie* evidence of competition among CRSs for travel agent business in the downstream market.

In addition, although CRSs offer different services in different countries, which may provide them with a competitive advantage, this does not appear to be sufficient to warrant a separate market definition, even in these countries, as the other CRSs could relatively easily replicate the services offered. Therefore it is concluded that CRSs are

¹⁷ See the assessment of market power section for a more detailed consideration of the flexibility that airlines actually have in terms of deciding which to CRSs to participate in.

viewed as substitutes for travel agencies, albeit to varying degrees, and the relevant product market is at least all CRSs.

Bypass of CRSs by other booking methods

OXERA is not aware of any full-service search and booking platforms that are comparable to the existing CRSs. In particular, the Internet-based portals have been suggested as alternatives, but all of these appear to use a CRS, or do not provide access to a full range of airlines.

As noted above, the main alternative to a CRS would be a non-automated system that relied on books of flight schedules and telephony-based information and booking systems, or searching individual airline web sites. However, in addition to the inefficiencies involved in using direct sales over a CRS, there are other reasons why a travel agent may prefer a CRS. CRSs bundle a number of services together, such as back-office software or network provision, which are provided in conjunction to the core CRS information search function. If there are economies of scope in combining these activities, it will be more expensive for a travel agent to contract for them independently, and use direct sales for its bookings.

Furthermore, the booking fee offered by CRSs directly acts to impede the use of direct sales. As a result of the productivity payments, the return to the agent from making a booking through a CRS is higher than that from direct sales. Without any substantial countervailing benefits of using direct sales, it is unlikely that direct sales could become a feasible CRS bypass option for travel agents.

If the CRS payment regime were to change considerably, or direct sales to offer additional benefits (such as speed or efficiency) that were not available through CRSs, direct sales could become viable as a bypass solution. This would be particularly the case on routings that were straightforward, or commonplace, where the agent was aware of the operators and potential tariffs. This is currently not likely to be a preferred option for travel agents, and hence should not be considered as a substitute in terms of constraining the prices charged by CRSs.

E-based ventures, such as Orbitz, an Internet travel agent in the USA, could also provide competition to the existing CRSs, but in doing so Orbitz would itself be defined as a CRS, and therefore should be considered a new entrant into the CRS market. This is discussed more fully below.

Geographic scope

The downstream retail market is national. While Internet and direct sales routes can be utilised cross-border, most passengers and travel agencies operate within their national boundaries. There appear to be a number of informal restrictions on passengers purchasing tickets in destination or third-country markets. In addition, customer uncertainty appears to limit the wide-scale use of foreign-based travel agents. Furthermore, the fact that air fares are in general different from country to country indicates that the geographic scope for the downstream market is national. For example, the fare for flights Paris - Hong Kong - Paris booked in France is different from that for the same flights booked in Hong Kong.

Conclusion

There do not therefore appear to be any substitutes to the CRSs in the downstream market. Accordingly the market is defined as the distribution of information and booking services by CRSs to travel agents on a national basis.

4.2 Assessment of market power

The next stage in the competition analysis is the determination of the existence of market power in the relevant market, and in particular whether there is any evidence of dominance. The European Court of Justice (ECJ) has defined the concept of dominance as follows:

Dominant position ... relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of its consumers.¹⁸

Thus, the essence of dominance is the power to behave independently of economic pressures in the market. This market power allows the firm to maintain prices above the competitive level or to engage in anti-competitive conduct to exclude competitors from the market.

A dominant position according to Article 82 can also be held by two or more undertakings, provided that they present themselves or act together in a particular market as a collective entity. In the EU, the concept of joint or collective dominance is used for such cases. The proof of the existence of a collective dominant position involves a two-stage process: it is necessary first to establish the existence of a collective entity and then, where such a position is found, to establish that the collective entity holds a dominant position.

EU case law established the necessity of 'economic links or factors which give rise to a connection between the undertakings concerned'. In later cases, the Court held that such links could be established by an agreement, decision or concerted practice, but that the existence of an agreement or other links in law is not indispensable to a finding. It would depend on an economic assessment and, in particular, on an assessment of the structure of the market in question. The Court has stressed the need to show that the entities do present themselves collectively because the links are, or the market structure is, such that they will be encouraged to align their conduct or to adopt a common policy in the market and to act to a considerable extent independently of their customers, competitors and consumers.

The checklist routinely applied by the Commission in joint-dominance cases seeks to evaluate the market in question against certain characteristics, which are deemed to

¹⁸ Case 27/76 *United Brands v. Commission* [1978] E.C.R. 207; [1978] 1 C.M.L.R. 429, paragraphs 65-66.

facilitate: tacit coordination, high concentration levels, homogeneous products, stable and symmetric market shares, stagnant demand, inelastic demand, high barriers to entry, similarity of cost structures, and low levels of technological change. This will be further discussed in section 5, which examines whether there is evidence of abuse of dominant position.

There are some significant differences in the dynamics of the upstream and downstream markets. The assessment of market power in these two is therefore dealt with separately.

4.2.1 Assessment of market power in upstream market

If the market is defined in the narrowest sense—i.e., that each CRS is a separate market—then it is obvious that each is dominant and possesses monopoly power. Hence this section discusses the likelihood of finding the existence of dominance even where the broader market definition is used in the upstream market. First, the current situation is examined from the perspective of parent and non-parent carriers. The scope for new entry is then considered.

The upstream market is regulated by the Code; as explained, the Code means that a distinction needs to be made between parent carriers and non-parent carriers. The Code obliges parent carriers to participate in each CRS. Unless the parent carrier is willing to forgo access to all the CRSs, and therefore to all the travel agents (apart from its own travel agents and other travel agents which have access to the parent carrier's own internal reservation system), they must participate in every CRS. From the perspective of parent carriers, the CRSs act as a collective entity.

What alternative options do parent carriers have to mitigate any abuse of market power by the CRSs? Discontinuing the participation in all CRSs is not a realistic option. An airline would lose most of the business from the thousands of travel agencies that are served by the CRSs. The market share of the CRSs is currently around 80%. Thus, from the perspective of a parent carrier, the CRSs act as a single entity and the carrier has no way to bypass them quickly. Hence, the CRSs should be considered to have joint dominance over parent carriers as they can behave independently of them.

Non-parent carriers are not obliged to participate in each CRS and therefore have the option to discontinue their participation in just one CRS. This flexibility can be shown to be more apparent than real. As explained above, each CRS provides airlines with access to a large, discrete group of travel agents (i.e., each CRS has a strong position in a number of national markets). If a non-parent carrier discontinued its participation in any one CRS, it would lose most of the business from travel agents in that particular CRS.¹⁹ Again, this means that it is not a realistic option for airlines to discontinue their participation in a CRS. This implies that the CRSs can behave independently of the airlines and hence

¹⁹ Some passengers will switch to another travel agent (and thus CRS), but in several countries the success of switching will be limited because of the strong market position of the most popular CRS. This means that a passenger may have to search very hard to find a travel agent not using the pre-eminent CRS.

should be judged to be either singly or jointly dominant. This is confirmed by the powerlessness of the airlines in negotiating any change in contractual terms with the CRSs. Indeed, the market structure is such that CRSs are encouraged to align their conduct and to act to a considerable extent independently of their customers. An example of this is the parity provision, which CRSs have included in the contracts with non-parent carriers. This issue of joint dominance (and tacit collusion) is discussed further in section 5.1.

New entry

At present it appears that airlines have little choice but to accept the terms and conditions offered by the CRSs. There may, however, be scope for airlines to disintermediate the CRSs over time.

The scope for competitive entry or self-supply to operate as a constraint on the market power of the CRS remains marginal in the upstream market. In the short to medium term, direct sales and the existing Internet-based booking systems constitute an inferior distribution platform for airlines seeking to supply information and booking services.

To what extent do new entrants exercise competitive constraints on the CRSs? New entrants into the market of CRSs face three major barriers: aggregation of sellers, the underlying technology to support the distribution infrastructure, and aggregation of buyers.

The aggregation of sellers (ie, airlines) can be achieved by establishing communication links with airlines in order to gain access to fares, schedules and availability, and by entering into contracts with airlines in order to be able to book their flights and issue their tickets. Establishing communication links requires capital, and 'signing up' airlines requires staff time. Given that most airlines predominantly serve particular geographic areas, it may be feasible to generate links to only the most important airlines in any market. However, this may be unattractive to agents that like to see all offerings and have one system. The size of the price differential required to compensate for such inconvenience is an empirical question.

The second barrier is the underlying technology to support the distribution infrastructure. This involves high (sunk) costs (for processing power, data storage, etc), time, technical talent and industry knowledge. It is difficult to give an estimation of the costs of building a new system.

The aggregation of buyers is another entry barrier. New entrants will have to obtain access to travellers. This can be achieved either by gaining direct access to travellers or by building relationships with travel agents.

The Internet may eliminate one of the three entry barriers by providing a framework to aggregate buyers through direct access to travellers. However, aggregating sellers into a single web site still requires communication links to be established and contracts to be agreed with airlines. Furthermore, it still needs the underlying technology to support the distribution infrastructure. Processing power, data storage, technical skills and industry knowledge are required to build such a distribution system.

This explains, at least to a certain extent, why all the on-line travel agents use existing CRSs to make bookings and to access flight information. On-line travel agents can be

described best as powerful search engines (using existing CRSs) that marry travellers and airlines without using conventional travel agents.

Existing on-line travel agents do not bypass the incumbent CRSs as yet. There are currently a number of attempts by the airlines to disintermediate the CRS by developing the Internet-based travel agent model further. For example, Orbitz was set up by five airlines (Delta, Northwest, Continental, American and United), and was initially the subject of an antitrust investigation, as it was alleged that the web site would offer lower fares than competing web sites. The US Department of Transportation ruled in April 2001 that there was no evidence of anti-competitive behaviour and the site was launched in June. Like most Internet travel agents, Orbitz does use a CRS; however, its arrangement is unique in that its deal with Worldspan does not involve the usage of its search engine but merely its connections to airlines. Even this is a temporary arrangement; Orbitz will have a direct link to a handful of airlines by the end of the year. Opodo, a European version of Orbitz, is currently being developed by a consortium of European airlines, but, like Orbitz, uses a CRS as its booking engine.

It's doubtful whether new Internet-based travel agents, such as Orbitz and Opodo, will succeed in significantly increasing competition in the upstream market. Bypassing the travel agents by trying to obtain direct access to travellers is only possible to a certain extent. The bulk of travellers still prefer to make their bookings through travel agents. When complexity or unusualness of the routing increases, travellers are more likely to book through a travel agent. Furthermore, although Internet-based travel agents may take some market share away from CRSs, CRSs will still have strong market positions. Unless airlines are willing to forgo access to all these travel agents, airlines will have to continue to participate in the CRS.

The other means of aggregating demand and bypassing CRS is through the travel agent, but gaining this access to travel agents is difficult. Travel agents often use only one CRS, may be locked into three-year contracts that make it difficult to switch to another provider, and are often provided with software and hardware by the existing CRS. New entrants have to establish a new brand, convince travel agents to use their system, and compete with the attractive incentive booking schemes that travel agents are offered by the existing CRSs.

The high levels of rebate offered by the CRSs to the travel agencies may form a significant entry barrier for new firms attempting to offer services that compete directly with the CRSs. The travel agents benefit considerably from the current system, and would be reluctant to lose this revenue. Moreover, they claim that the rebates are necessary to cover their costs of business, and, if the contribution did not come from CRS rebates, it would have to be recovered from elsewhere.

If the new arrangements were to offer a comprehensive service, this new deal would need to be negotiated with the majority of airlines simultaneously, which may be problematic. Hence, it would be very difficult for a competitor to the CRSs to attract travel agents to use its system without offering the same rebates, or similar cash inducements. Given the overall cost of providing such inducements, any new entrant would need to use the same basic economic model as the existing CRSs.

In other words, it is difficult to consider a business case in which a CRS competitor could profitably enter the market without charging the airlines in a similar fashion to the

existing CRSs. Such a competitor is thus unlikely to be able to offer airlines a new business model that would be preferable to the existing CRS charging structure. Without a means of attracting either agents or airlines, entry is likely to be very difficult.

One particular impact of this conclusion is that it is unlikely that agents will use the Internet as a substitute for the CRSs so long as the current payment structure remains in place. Thus it is only domestic purchases of travel services via the Internet that will be the available market for these on-line agents.

Consequently, it is not likely that a new entrant will put sufficient competitive pressure on the incumbent CRSs to prevent them setting prices and contractual terms independently of their airline customers. Thus the threat of new entry does not reduce the (joint) dominance of the CRSs over the airlines.

4.2.2 Assessment of market power in downstream market

As shown in Table 4.1, each CRS has a high market share in a number of national markets, higher than the European Commission's threshold of 50-60%. This would lead to a strong presumption of dominance for the CRS, with the strong presence in the given downstream market. Furthermore, as explained above, evidence of fidelity or volume discounts structured to drive the marginal purchase towards the CRS limits effective competition from other sources, such as direct sales (over the telephone and through a web site). The incentive schemes may also form a strategic entry barrier for new entrants.

The increasing booking incentive schemes (and up-front payments) offered by CRSs to travel agents could indicate fierce competition in the downstream market. There are three incentives for CRS companies to compete for the business of a travel agent:

- even for a medium-sized travel agent, the booking-fee revenue that a CRS company can gain from airlines is considerable;
- there are significant scale economies for CRSs—unit costs decrease as booking volumes grow;
- the larger the CRS market share in a given downstream market, the stronger its position towards the airlines in the upstream market and the stronger it is in comparison with its competitors in attracting other travel services to its platform on good terms.

The costs of the incentive schemes appear to be borne by the airlines that have little control over the CRSs' marketing and pricing strategy towards the travel agencies. As described above, the degree of competition in the upstream market is very low, enabling CRSs to pass on the costs of the incentives schemes to the airlines. This would mean that the existence of increasing incentive schemes is not necessarily (only) an indication of fierce competition—it is both a symptom of poor incentives and an indication of fierce competition. The fact that travel agents receive most CRS services free, while booking fees charged to airlines have increased considerably over the past five years, indicates that competition in the downstream market is stronger than in the upstream market. What is less clear is whether CRSs would continue to compete as fiercely for travel agency business if they could no longer easily pass the costs of this competition on to the airlines.

In summary, some CRSs have a very strong position in some national markets; however, the CRSs that are smaller in each market appear to compete for this business. Agents that

tender for their CRS business generate multiple participants that offer competitive bids. With evidence of this, it is difficult to argue that any individual CRS has the power to behave to an appreciable extent independently of its competitors and customers, since other CRSs appear to compete with it. Further, detailed investigation of any particular national market may reveal that the generic picture of competitive tendering does not hold, in which case the incumbent may be shown to be dominant. In general, the conclusion is that any one CRS is unlikely to be dominant in a downstream market; the goal is to harness these competitive forces to yield better outcomes for passengers and airlines.²⁰

²⁰ This does not preclude that CRSs may be found to be jointly dominant in any market, nor that particular actions on the part of an incumbent may be found to be anti-competitive (for example, contractual terms that dissuade agents from switching). Such practices are discussed in the next section.

5. Evidence of Anti-competitive Behaviour

Having analysed the existence of market power in the relevant markets, this section sets out the airlines' current complaints in the context of potential anti-competitive practices.

5.1 Tacit collusion

Joint dominance can be defined as a market structure of tight oligopoly that is unsatisfactory from a public-policy viewpoint, in which firms, recognising their mutual interdependence, behave in a coordinated fashion that is not competitive, but that does not involve an explicit anti-competitive agreement. It should be recognised that the mere fact that firms recognise their interdependence with other firms is not sufficient grounds for inferring that observed outcomes are not the result of effective competition. Coordinated behaviour (tacit collusion), but not mere oligopolistic interdependence, is what leads to a situation of joint dominance, as defined here.

A number of criteria for assessing joint dominance, on both the supply and demand side, have been identified in EU competition case law. It is against these criteria that the upstream CRS market can be assessed.

- *Number of firms*—as a general rule, tacit collusion is more likely in tight oligopolies with few firms. Apart from in the Far East, the CRS market is dominated by four firms. This is well within the general rule employed by the US Horizontal Merger Guidelines, which state that markets with up to five or six firms are likely to raise concerns about tacit collusion.
- *Size distribution of companies*—tacit collusion is normally easier between firms with similar market shares. This is again a feature of the CRS market—Galileo, Sabre and Amadeus control approximately 30% of both the upstream and downstream market, with Worldspan taking the remaining 10%.
- *Market shares over time*—stable market shares, as have been witnessed in the CRS industry, are also a possible signal of tacit collusion. Sabre and Worldspan have remained the dominant players in the USA, while Amadeus continues to control the European market. The only changes that have occurred have been as a result of the capture of a new market, such as Sabre's successful foray into the Far East.
- *Homogeneous product*—where competition focuses on price alone, tacit agreements are reached more easily, as firms only need to collude along one dimension. The CRS industry is characterised by limited product differentiation, as most airlines take the full functionality offered by all four major CRSs.
- *Transparency of prices*—tacit agreements are easier to sustain where quick detection of 'cheating' is possible. The prices charged by each of the four major CRSs are always freely available, and the existing rules that prevent a CRS charging different prices to different airlines further facilitate collusion.

- *Structure of costs*—firms in high-fixed-cost industries may be more susceptible to collusive outcomes. They will want to ensure that they operate at full capacity to spread the fixed costs as much as possible, and will all have the incentive to keep prices high enough to recover these fixed costs.
- *Cost differences*—if firms have similar marginal cost functions then individual price preferences at given levels of output are unlikely to differ greatly, making it easier to sustain collusive outcomes. It is highly likely that the four CRS companies have similar cost structures.
- *Technological development*—markets with little technological change, particularly if combined with high fixed costs (see above), may also be prone to collusion. This is because there is less scope for new competitors to enter the market with innovative products, and because competition, as with product differentiation, tends to take place along fewer dimensions.
- *Past and current behaviour*—this can give important indication of tacit collusion (pricing and market strategies are particularly useful in this regard). The CRS market is unusual, in that prices in the upstream market are fixed once a year, with the changes occurring almost entirely on the same date. Galileo, Amadeus and Worldspan brought in their new pricing on January 1st 2001; Sabre's rates increased on February 1st.

The CRS industry exhibits a number of characteristics that make it easier to reach tacit agreements regarding the setting of prices. The possibility of collusive behaviour is enhanced by the existing incentive structure in the upstream market. Each company knows that all the international airlines are obliged to participate in each CRS to reach travel agents in all countries, and therefore have little incentive to compete on price. The simple fact that booking fees are raised year on year at roughly the same time by all four CRS companies suggests that competitive forces are working imperfectly in this market.

Parent carriers are obliged under the Code to participate in all CRSs. This makes the CRSs act as one entity. Furthermore, the CRSs have a parity provision in their contracts with participating carriers that requires the carrier to participate in as high a level in their system as in any other system. The parity provision prohibits a carrier that participates at the most basic level of Sabre, Worldspan, Amadeus and Galileo from upgrading to a higher level in, for example, Sabre, unless it also upgrades to a higher level in the other three CRSs. Likewise, for example, if a CRS's product and services deteriorate (or a CRS increases its price without improving its services), the provision prevents a carrier from downgrading its participation level in that CRS unless it also downgrades its level in

every other CRS. The parity provision thus reduces the need for CRSs to compete with each other to make their enhanced service levels attractive to participating carriers.

5.2 Excessive pricing

Studies of the CRS industry by both Global Aviation Associates Ltd and Garrett Communications Ltd report that the prices charged to airlines by the CRS companies have increased substantially year on year.²¹ Table 5.1 shows the increase in booking fees over the last five years. Prices have increased, on average, by 5% per year.

Table 5.1: Booking fees increase per year (%)

CRS	1996	1999	2000	2001
Amadeus	3.3	5.2	4.5	6.9
Galileo	4.0-7.4	3.4	5.4	6.0
Sabre	7.0	2.9	3.5	7-10
Worldspan	2.2-7.2	3.5	5.9	4.0

Source: Global Aviation Associates, Ltd. (2001). (Garrett Communications shows similar price increases.)

Debates between the carriers, CRSs, travel agencies and the regulatory bodies have already taken place concerning the basis on which the CRSs calculate the level of fees to be charged for their services. One specific complaint was that the productivity pricing agreements in existence in the downstream market were borne by the airlines. In 1997, the European Commission commissioned consultants, SH&E, to carry out a detailed examination of CRS charging policies in response to these complaints.²² The Commission was persuaded that the incentive payments awarded to subscribers were legitimate distribution costs and could be included in the booking-fee calculation, but the wider question of whether the overall booking fee was cost-reflective was not answered.

Sabre's Annual Report 2000 mentions that:

[the] cost of revenues for electronic travel distribution increased approximately \$86 million, 9.4%, from \$916 million to \$1,002 million. This increase was primarily attributable to increases in subscriber incentive expenses, data processing costs and salaries and benefits, partially offset by reductions in expenses associated with the Marketing Cooperation Agreement with American. Subscriber incentive expenses increased in order to maintain and expand the Company's travel agency subscriber base.

This makes clear that the increases in booking fees are, at least partly, due to higher incentive payments offered to travel agents. In the downstream market, the CRSs compete

²¹ Global Aviation Associates (2001), 'The History and Outlook for Travel Distribution in the PC-based Internet Environment'

²² European Commission (1997), 'Report on the Application of Council Regulation NO.2299/89 on a Code of Conduct for CRSs, Proposal for a Council Regulation (EC) amending Council Regulation No.2299/89 on a Code of Conduct for CRSs', Brussels, July, COM (97) 246.

against each other for travel agents on the level of incentive payments. In order to maintain or expand its market share, a CRS needs to overbid its rivals—ie, to increase the incentive payments to travel agents. The higher costs of these incentive payments are subsequently passed on to the airlines in the form of higher booking fees. The higher incentive payments a CRS pays to travel agents in order to keep its market share are of no benefit to the airline in a market where CRS penetration is already very high. It may result in better deals and services for travel agents, but not in better services for airlines. The overall outcome for final customers is uncertain, but in mature markets there is likely to be a tendency to inflate total costs. It therefore no longer seems legitimate to argue—as the European Commission did in 1995—that all incentive payments awarded to subscribers are legitimate distribution costs.

Analysis of the profitability of the CRS companies raises further questions as to whether excessive pricing exists within the industry. Table 5.2 shows the return on equity of the three CRSs that are listed on an exchange.²³ It is difficult to find a benchmark against which the profitability of CRSs can be assessed.

A benchmark that could be investigated further is the booking fees that fall under the Amadeus user agreements. These agreements are for airlines using the Amadeus internal reservation system. The fees that Amadeus system users pay for bookings made through the direct sales distribution channel (ie, telephone, own web site or travel agent) appear to be lower than the 'normal' CRS booking fees. The difference may be due to differences in the type of service; the fact that, for direct sales bookings, no incentives are paid to travel agents; and profit margins. In order to investigate fully whether this could serve as a benchmark, it would be necessary to determine the extent to which the services under the system-user agreements are comparable to normal CRS services.

It is clear that the return on equity of the three CRSs shown in Table 5.2 is high. For comparison, the return on the FTSE 100 index was on average 15% over the past five years.

Table 5.2: Return on equity (%)

CRS	Return on equity (1998)	Return on equity (1999)
Amadeus ¹	n.a.	40
Galileo	23	55
Sabre	24	28

Note: ¹ The return on equity of Amadeus for the year 2000 is 26%. ² The return on equity is calculated as profit after tax and interest payments divided by total equity.
Source: CRSs' annual reports; OXERA calculations.

²³ Another indicator is the operating margin. The operating margin for Amadeus is, on average over the past five years, 15%, for Galileo 20% and for Sabre 15.5%. The capital intensity—measured as total fixed assets as a proportion of turnover—is 23% for Amadeus, 19% for Galileo and 24% for Sabre.

5.3 Cross-subsidisation

Article 10.1 of the Code requires that:

Any fee charged by a system vendor shall be non-discriminatory, reasonably structured and reasonably related to the cost of the service provided and used and shall, in particular, be the same for the same level of service.

This requirement only applies to those companies that are subject to the Code—ie, the airlines. CRSs now do much more than serve the airlines. Recent years have witnessed a growth in the bookings made through their systems on behalf of their other customers, such as car-rental companies, hotel chains and rail companies, as Table 5.3 demonstrates.

Table 5.3: Non-air bookings, 12 months ended September 30th

	1999 (no of bookings, m)	2000 (no of bookings, m)	% change
Sabre	38.9	42.9	+11
Galileo	29.1	29.4	+1
Amadeus	27.4	29.6	+8
Worldspan	13.7	15.9	+16
Total	108.8	117.8	+8.2

Source: Garrett Communications (2001), '2001 GDS Yearbook'.

It is possible that the booking fees charged to the airlines are being used to finance the cost of providing CRS services to these other companies. It is not clear whether providing services to these other suppliers of travel vendors involves significant new costs for the CRSs. If the provision of such booking capabilities to these companies requires significant new investment, and airlines' fees are cross-subsidising these costs, the profit figures reported by the CRSs in relation to airlines could be understated. It could be argued that the provisions of the Code that require cost-reflective pricing need to be extended to all suppliers of travel services.

5.4 Anti-competitive practices in the downstream market

The current high levels of productivity payments offered by the CRSs to the travel agents raise several issues of possible anti-competitive practices in the downstream market.²⁴

5.4.1 Cash-back as an entry barrier

The high levels of cash-backs offered by the CRSs to the travel agencies may form a significant entry barrier for new firms attempting to offer competing services to the CRSs. The travel agents benefit considerably from the current system, and would be reluctant to

²⁴ Obtaining high-quality information on commercial agreements between CRS and travel agents has proved difficult. The discussion below is based on information from the two large travel agents.

lose that benefit. Moreover, they claim that the rebates are necessary to cover their costs of business, and, if the contribution did not come from CRS rebates, it would have to be recovered from elsewhere.

Hence it would be very difficult for a competitor to the CRSs to attract travel agents to use its system without offering the same rebates, or similar cash inducements. Given the overall cost of providing such inducements, any new entrant would need to use the same basic economic model as the existing CRSs.

5.4.2 Productivity bookings are volume rebates

Productivity payments are basically quantity rebates. When the contracts are negotiated, the agent specifies its expected number of bookings in the relevant time period (usually on an annual basis), and the CRS quotes a booking rebate on the basis of this figure. The CRS will offer larger per-booking rebates to the agent, the greater the number of bookings that it commits to put through that CRS. The CRS may use the opportunity of higher per-booking rebates to encourage the agent to commit to produce very high levels of bookings in any one year. Such incentives then encourage fictitious and duplicate bookings by agents.

Most of the CRS agree a flat per-booking rebate that applies to all bookings by the agent, regardless of the final annual total. However, the booking targets are an effective incentive regime because of penalties for the failure to meet them. The agent is charged for the shortfall in the number of bookings below the target, and this per-booking charge generally exceeds the value of the rebate from the CRS.

For example, OXERA found evidence of a CRS tariff that offered a £1 rebate per booking, with a penalty charge of £1.50 per booking below the target.

The granting of rebates is a common fact of commercial life and a major way in which suppliers compete on price and attempt to attract customers to themselves and away from competitors. The ability to grant discounts is not a characteristic of market power, but case law on Article 82 establishes that, where undertakings are dominant, their discounting policies will be severely constrained. In Irish Sugar, the Court of First Instance summed up the approach of EU competition law to pricing policies:

the case law shows that, in determining whether a pricing policy is abusive, it is necessary to consider all the circumstances, particularly the criteria and rules governing the grant of the discount, and to investigate whether, in providing an advantage not based on any economic service justifying it, the discount tends to remove or restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transaction with other trading parties or to strengthen the dominant position by distorting competition [Hoffman-La-Roche, paragraph 90; Michelin, paragraph 73]. The distortion of competition arises from the fact that a financial advantage granted by the undertaking in a dominant position is not based on any economic consideration justifying it, but tends to prevent the customers of that

dominant undertaking from obtaining their suppliers from competitors [Michelin, paragraph 71]. One of the circumstances may therefore consist in the fact that the practice in question takes place in the context of a plan by the dominant undertaking aimed at eliminating a competitor [AKZO, paragraph 72, Case T-24/93 *Compagnie Maritime Belge*, paragraphs 147 and 148].²⁵

The effect of the discount structure has some characteristics similar to fidelity discounts. This drives most travel agents to use only one CRS in any geographic region. If an agent contracted with more than one CRS, the volume spread across each CRS would be reduced, and the per-booking fee payments would be smaller. The volume discounts are structured to drive the marginal purchase towards the CRS, which limits effective competition from other sources, such as Internet-based travel agents or direct sales.

5.5 Discriminatory pricing

Generally speaking, large travel agents are offered better terms than smaller travel agents. They make more bookings and therefore benefit more from the volume discounts. Furthermore, some of them—in particular, consolidators—are in a better negotiating position than smaller travel agents, as they use their own hardware and software and can easily switch from one CRS to another.

The impacts on the retail market of the deals between different types of travel agent and CRSs are unclear. Large agents are placed in an advantageous position as a result of the discriminatory pricing, but the overall value of the benefits may not make a significant amount of difference. The fact that smaller travel agents continue to exist alongside larger firms suggests that the inequalities of the current system are not such as to force smaller agents from the market.

In order to investigate this issue fully, it would be necessary to determine the exact level of CRS rebates made to different-sized firms, and establish the total sums of money involved compared to the aggregate cost base of each type of agency.

5.6 Consumer detriment

The analysis set out above indicates that there are a number of both static and dynamic market failures in both the upstream and downstream market, and in particular when the two markets are taken together. Airlines are faced with CRS suppliers with considerable market power; travel agents have incentives to behave in a way that increases total costs; and market shares in local markets are high, and very stable.

However, these market failures arise in the intermediate markets of the supply of information and seat-booking services. Although it is likely that failures in intermediate markets result in failures in the final-product market (which, in this case, is the actual passenger journey), it is not automatically the case. For a competition authority, this

²⁵ Case T-228/97, *Irish Sugar plc v. Commission*, judgement 7 October 1999 [1999] 5 CMLR 1300.

distinction is important, as competition is a means to an end, not an end in itself. If there is no significant detriment in the final-product market, a competition authority may choose not to take action to correct distortions in the intermediate markets.

For example, in the above analysis, the airlines are in a weak position relative to CRSs, and the booking fees (ie, prices) paid to CRSs have increased. In turn, however, CRSs have been passing on more to the travel agents, the costs of which are reflected in the CRSs' cost base. If competition between travel agents for customers competes away the additional revenue received from the CRSs then consumers may be no worse off as a result of increased payments by airlines to CRSs. This will be the case when travel agents use the revenue to produce benefits valued by customers (including discounting ticket prices), even if the original payments from airlines to CRSs are not related to the basic costs of running a CRS system. It is therefore possible that actual ticket prices are no higher than they would be if the intermediate markets were more effectively competitive.

6. Summary of Economic Analysis

The CRSs can be considered a distribution platform through which airlines sell tickets to travellers, via either traditional or Internet travel agents. From a technical point of view, each CRS offers the same kind of services and functionality (search, booking and ticketing functions). However, the CRSs have different geographic strengths. For example, Amadeus offers access to most of the travel agents in Germany (82%), Sabre gives access to 40% of the travel agents in the USA (and only to 5% of the travel agents in Germany), while Galileo has a market share of 73% in the UK.²⁶

6.1 Airline-CRS relationships

The CRSs are not substitutes from the airlines' perspective—each CRS provides access to a large, discrete group of travel agents. This means that, for the airlines, participation in all the four major global CRSs is essential, even if it is not mandatory for non-parent carriers. If an airline were not to participate in even one of the major CRS companies, it would lose much of the business from the thousands of travel agencies that are served by that particular CRS. Thus, from any major airline's perspective, each CRS constitutes a separate market and each system possesses market power over the airlines.

However, in the long run, CRSs may be considered substitutes. This mainly depends on the level of switching among CRS users—the travel agents and indirectly travellers themselves. For example, if an airline discontinued its participation in one of the CRSs, the airlines would not lose all the travel agents/consumers in that particular CRS. It is possible that, in the long run, some of the travel agents would switch to another CRS, while it is also feasible that some travellers would use an alternative travel agent linked to a different CRS.

Furthermore, it could be argued that direct sales (either telephone-based, or those through airlines' own travel agents or web sites) can be regarded, at least to a certain extent, as a substitute for CRS. For some airlines, direct bookings are an important distribution channel, particularly for domestic sales. None the less, the direct sales distribution channel remains an imperfect substitute. The probability of consumers using a traditional or on-line travel agent (and hence a CRS) increases as the consumer's required routing becomes more complex or unusual. This is because the CRS is a very efficient means of comparing different options. Hence, although all CRSs could be seen to be in the same market, in the short term, it is recognised that global airlines have no choice other than to subscribe to each of the four largest CRSs in order to gain access to their travel agents (and thus potential travellers).

In the long run, CRSs may face competitive pressures from new entrants. New entrants into the CRS market face three major barriers: aggregation of sellers, underlying technology to support the distribution infrastructure, and aggregation of buyers.

²⁶ As at 1995. Indications are that its market share has since fallen.

The Internet eliminates one of the three entry barriers by providing a framework to aggregate buyers. However, aggregating sellers still requires establishing communication links and entering into contracts with airlines. Furthermore, it still needs underlying technology for data storage and processing. This explains why all Internet travel agents use existing CRSs to make bookings and to access flight information. The existing Internet travel agents do not replace the CRSs but only disintermediate the traditional travel agents. The development of Orbitz is an attempt by US airlines to disintermediate the CRS.

It is doubtful whether initiatives such Orbitz will succeed in increasing competition in the upstream market. Bypassing the travel agents by trying to obtain direct access to travellers is only possible to a certain extent. In addition, if Orbitz wants to obtain access to travel agents, it will have to compete with the agent's existing CRS, which will be offering high volume discounts. Hence, it would be difficult for any new entrant to attract travel agents without offering the same rebates or similar cash inducements. Given the overall cost of providing such inducements, any new entrant would need to use the same basic economic model as the existing CRSs. In sum, it is not likely that a new entrant will put substantial competitive pressure on the incumbent CRSs.

6.2 CRS-travel agent relationship

The relationship between CRSs and travel agencies is very different. While most travel agents tend to subscribe to only one CRS, the main CRSs are considered substitutes by the travel agents. An agency selects a CRS on two key criteria:

- attractiveness of functionality and services; and
- price (generally in terms of level of discounts).

There appears to be competition between the CRSs to sign up travel agents to their particular system. The more travel agents a CRS acquires, the more bookings it receives through its system and the higher its revenues. It should be noted that the US and European downstream markets are largely saturated. CRSs are therefore not competing for new travel agents, but attempt to take market share away from each other.

6.3 Pricing policy

Each CRS adopts a similar charging structure, with airlines charged a booking fee whenever a reservation is made through the CRS system. The CRSs have significantly increased the booking fees over the past five years, on average by 5% per year. As the alternative methods of distributing information to travel agents are very limited, there is no competitive pressure on the prices set by the CRSs. It is not clear whether the price increases have been caused by higher costs, increases in the level of services or functionality provided, or whether they have contributed to higher profits. Most likely is that a mix of all three explanations is relevant.

The CRSs possess market power over the airlines which has enabled them to impose the price increases, and to make high profits without the threat of a demand response of the airlines. Airlines already do not have a realistic option of discontinuing their participation in a CRS, and, further, they do not directly control the volume of bookings made that result in the costs charged to them.

The pricing structure for travel agents is different. Travel agents effectively create revenue for the CRSs, as each booking originated by an agent allows the CRS to charge the airline a booking fee. In order to maximise the number of bookings made by a travel agent through a particular CRS, the CRSs use 'productivity bookings', which are basically loyalty discounts. The CRSs appear to use part of the booking fee to cover their costs of acquiring the travel agents' business (mainly the productivity payments).

6.4 Summary

CRS distribution is a joint product that offers services to both airlines and travel agents. CRSs do not compete for airlines to subscribe to their systems, but appear to compete vigorously between themselves for travel agents' business. This peculiar structure of the markets in which the CRSs operate has led to the following.

- Significant increases in the booking fees charged to airlines by the CRSs—on average 5% per year over the past five years. Although the cause of these price increases is unclear, the annual report of one of the CRSs mentions that the price increases were necessary due to higher costs of productivity booking schemes for travel agents.
- The CRSs make relatively high profits.
- In the upstream market, the CRSs do not operate in a competitive environment, which may have led to inefficiencies in the CRSs.
- As the airlines provide the majority of CRS revenues, they effectively cover most of the CRS costs, and pay for most of the services provided by CRSs to travel agents, such as hardware and back-office software.
- The European and US markets for travel agents are largely saturated, which means that the vigorous competition among CRSs for travel agents is of no benefit to the airlines. It does not generate greater numbers of bookings, but results in better deals for the travel agents and therefore in higher fees per booking for the airlines.
- Travel agents are paid for each booking. This gives them an incentive to inflate the number of bookings they make—for example, with fictitious or duplicate bookings.
- CRS may use the booking fees charged to the airlines to finance the cost of developing CRS services for other travel sectors, such as car rentals and hotels (cross-subsidisation).
- The high level of cash-backs offered by the CRSs to the travel agents may form a significant entry barrier for new firms attempting to offer competing services to the CRSs. It would be very difficult for a competitor to the CRSs to attract travel agents to use its system without offering the same rebates, or similar cash inducements. Given the overall costs of providing such inducements, any new entrant would need to use the same basic economic model as the existing CRSs.

- The productivity bookings have some characteristics similar to fidelity discounts. The volume discounts are structured to drive the marginal purchase towards the CRS, which limits effective competition from other sources, such as Internet-based travel agents or direct sales.
- Distribution costs are high due to relatively high CRS profits and possible inefficiencies in the CRSs. This reduces consumer welfare.

7. Critique of Political Solutions

The analysis of the CRS market has indicated that relying upon technological innovation and the development of Internet-based alternatives is unlikely to limit the market power wielded by Sabre, Galileo, Amadeus and Worldspan with respect to most, if not all, major airlines. For the foreseeable future, a significant part of the market for air transport will be economically accessible only through CRS systems. Even though the downstream market exhibits some anti-competitive characteristics, it is already more competitive than the upstream market, and, unlike the upstream market, there are fewer fundamental problems relating to the operation of effective competition in this market.

The problems with the current market dynamics, especially with respect to the upstream market, flow primarily from two sources: the market power of the CRS operators with respect to airlines; and the interaction between the upstream and downstream markets through the CRS operators. Thus, in economic terms, there are three types of remedy that could be used to address the problems identified in the upstream market:

- introduce changes in the upstream market that reduce or remove the market power of CRS systems with respect to airlines, by enabling effective competition to operate between CRSs;
- introduce more effective regulation of CRS operators to directly counter their market power;
- introduce regulation that harnesses the competitive dynamic in the downstream market to counteract the market power in the upstream market.

In practice, the number of forms of remedy that could be pursued is limited. The three forms analysed in this section focus on:

- changing the Code;
- monitoring the CRS cost base;
- altering the price arrangements to align incentives more closely.

Changing, or removing, the Code is designed to make it easier for airlines to negotiate with the CRSs, and hence improve the balance of bargaining power between the two parties. The current obligations on airlines (see section 2) mean that parent carriers are faced with an imposed 'all-or-nothing' choice, inherently weakening their negotiating position with each CRS.²⁷ Relaxing the obligations on airlines to enable them to choose different levels of functionality, participation that differs across regions, or even the option to delist from a CRS if they do not like the terms they are being offered, may improve the commercial relationship between each airline and CRS.

²⁷ While only 'parent' carriers are obliged under the Code to offer the same level of functionality in all CRSs, contractual clauses effectively require 'non-parent' carriers to do the same (eg, Amadeus Participating Carrier Agreement, November 1999, Article 2 Clause 1).

However, altering the Code so as to increase the freedom of carriers may not actually succeed in significantly altering the balance of power between airlines and CRSs. As discussed in section 4, the CRSs may have strong individual market power as a result of their control of access to a significant proportion of the distribution chain. If so, changing or removing the Code to give airlines more potential freedom will not actually deliver significantly more freedom, and will not therefore alter the balance of power.

A further potential remedy is to encourage regulatory scrutiny of the CRS cost base. The most extreme form would be full price regulation, with the regulator assessing the appropriate level of costs that should be borne by the airlines. Less intrusive options could include requiring CRSs to be more transparent about their costs. Regulation—in the sense of intervention by the application of rules on behaviour—would be used directly to redress the balance of power in the upstream market.

The third remedy discussed below would require the most significant change to industry practice. This would be that the bulk (if not all) of the charges for booking fees are paid to CRSs by *travel agents*, not airlines. The agencies then recoup these costs through the commission structure from airlines. As with other travel agency costs, such as overheads, the fee for use of CRS systems would be covered by the commission arrangements.

Shifting the payment obligation to the travel agents ensures that they have a strong incentive to bargain hard with CRSs to deliver value-for-money reservation services. As airlines would offer a commission rate to agencies which would be set without a *direct* link to the price that agencies would pay CRSs, there is no direct cost pass-through. Hence, individual travel agents would increase their profit by having a lower cost base (ie, lower CRS prices) than their rival agencies. Competition for travel agency business among the CRSs would be expressed by driving down the prices (and hence costs) of providing CRS booking services.

At present, competition for travel agency business leads to an increase, rather than a decrease, in the cost base of CRSs, as they increase their incentive payments to agencies. In its 1999 annual report, Sabre primarily attributed its 9.4% increase in the cost of revenues associated with electronic travel distribution to 'subscriber incentive expenses, data processing costs and salaries and benefits'.

A remedy of this sort would still require regulation of the upstream market to ensure that CRSs did not exploit their market power relative to airlines. However, such regulation would be economically simple, as its objective is to shift the economic complexities that can be solved by competitive markets into the more competitive, downstream, market. It therefore relies on the downstream market itself having sufficiently robust competitive characteristics to fulfil this role.

In particular, if travel agencies cannot easily switch between CRSs, then changing the pricing arrangements would not be successful in putting downward pressure on CRS prices. Thus the contractual terms between CRSs and travel agencies may also need to be changed to ensure that switching is facilitated. Other action may also be needed to address any market power issues that arise in the local downstream markets. However, the fundamental economic characteristics of the downstream market are significantly better than the upstream market—travel agents do have an effective choice of CRS, airlines do not—so an effective competitive solution is more likely to be attainable.

In the sub-sections below, each remedy is outlined in more detail.

7.1 Remove or modify the Code

The Code was designed to prevent those airlines that owned a controlling stake in a CRS from exploiting their position in either the CRS market or in the airline market. Airlines could disadvantage competing CRSs by refusing to provide schedules, fares and availability to the rival platform. They could also discriminate against rival carriers via booking fee bias, which would involve the CRS charging lower fees per booking to its parent carriers than to its rivals. The Code addressed these practices by obliging all parent carriers to participate at the same level of functionality in each CRS, and requiring each CRS to charge all airlines the same price for similar services.

The operation of the Code has meant that certain airlines are unable to exercise any choice as to which CRSs they participate in, which has in turn provided no incentive for the four CRS companies to compete on price. Accordingly, four types of changes to the Code are suggested:

- remove it completely;
- allow carriers to opt out of any CRS;
- allow all carriers to choose different levels of functionality across CRSs;
- allow carriers to adjust the level of participation in different regions.

7.1.1 Removing the Code

Removing the Code completely would be designed to return bargaining power to carriers, as the obligations on common pricing and common functionality would disappear. However, as long as the airlines have ownership stakes in any of the CRSs, there will remain risks that they could abuse their position in either the CRS market or the airline market, or both. Even if the airlines themselves do not feel that this is likely, the Commission is unlikely to risk removing the Code completely. In the absence of complete divestment of CRSs by all airlines, some regulatory control of CRSs that have airline equity stakes is likely.

Although controls equivalent to the existing restrictions on parent carriers would, in practice, remain, the current form of regulation is not necessarily essential. If the Code were to be removed, but controls on parent carrier-owned CRSs retained, a different regulatory structure could be used. There are two potential solutions: ring-fencing the investments; or reintroducing certain provisions to alleviate Commission concerns.

The first of these options would be for the airlines to remove even their *potential* influence over the operations of the CRSs. This could be achieved by ring-fencing their CRS investments, or giving up their voting right on certain issues. For example, this could mean that airline board members are not allowed to discuss issues, such as booking-fee increases or commercial policies towards airlines. The practicalities of such measures may, however, be prohibitive.

An alternative option is to reintroduce controls on the CRSs in respect of certain core areas of concern, such as display bias or differential booking fees. These could be relatively light regulation—for example, a requirement to act in a ‘fair, reasonable and non-discriminatory’ at all times towards all airlines on the issues of concern.

Despite the need to retain some regulatory oversight of the CRSs, there may still be benefits from removing a number of elements of the Code. An unwieldy and dated piece of regulation could be replaced with lighter-touch, more sophisticated, regulation that took account of current market practices and characteristics.

7.1.2 Opting out of CRSs

The first potential change would be to allow any carrier (including parent carriers) to opt out of a CRS. If an airline chose to remain subscribing to any CRS, it would be subject to the requirements of the existing Code. Thus, if a carrier is unhappy with the terms offered, or the level of service, it could cease to participate in that CRS.

Non-parent carriers in effect already have such freedom, as they are not bound by this aspect of the Code (although, as already noted, CRSs have included parity provisions in non-parent carrier agreements). However, as described below, in practice it may not be possible for the airlines to exercise any freedom they may gain, and they are effectively compelled to remain members of all the CRSs.

For parent carriers, a potential opt-out would also increase their freedom. However, if they chose to exercise it, there would be a significant danger that such behaviour would be seen as being anti-competitive.

In practice, therefore, the removal of the requirement for parent carriers to participate in CRSs would be likely to lead to the development of a more complex set of 'rules' or regulations in order to determine when such a refusal was reasonable rather than anti-competitive. Hence there is a significant likelihood that parent carriers would also ultimately not benefit greatly from this change.

It is also arguable whether such a change would have any impact on the prices charged by CRSs. Airlines, such as BA, are already able not to participate in a given CRS, since they are no longer parent carriers—although this choice may actually be illusory, as explained below.

The problem for any large airline in Europe, whether or not it owns a CRS, is that each of the major four CRSs controls thousands of travel agents around the world. By not participating in a particular CRS, the airline potentially loses all the travel revenue that would have emanated from the travel agency network served by that CRS. The cost of losing access to these agents is likely to far outweigh the transactional costs (mainly the booking fee) from participating in the respective CRS. If airlines are to overcome this problem, they would need to be able to rely on travel agents switching CRSs (to one within which they do participate), or potential customers switching travel agents (to one which uses a CRS in which they participate) or to non-CRS distribution methods. In some downstream (national) markets, this might be the case, but it is unlikely in those markets where:

- the airline represents a small part of the travel agent's airline business; or
- the CRS has a high share of the national (travel agent) market.

However, many, if not most, of the main national markets will have one or both of these characteristics for major international airlines. Therefore allowing opt-out may not actually provide airlines with any greater choice over which CRSs they are able to participate in.

7.1.3 Choice of functionality

The second change would be to give all airlines the ability to participate in CRSs at different levels of functionality, as a means of facilitating more competition between the CRSs for the business of the airlines. Currently, all four CRSs have a parity provision in their contracts with participating carriers that requires non-parent carriers to participate in as high a level in their CRS system as in any other system. Allowing airlines to choose their functionality level between CRSs would in effect also mean prohibiting the parity provisions included in the non-parent carriers' contracts with the CRSs.

Each CRS provides various levels of service to participating carriers, with the basic level costing about half as much per segment booked as the highest functionality. If an airline decided that the prices charged by one CRS were too high, it could reduce functionality and pay for just the basic product, reducing its CRS costs in the process. However, if a CRS does not induce airlines to take full functionality in their system, they risk losing travel agency clients because the quality of the end product provided to the travel agents is diminished.

Without parity conditions, in order to induce the airlines to accept full functionality, CRS companies will have to compete on quality and price to ensure that airlines are taking similar levels of functionality in their system as with the CRS's rivals. This argument is predicated on strong market forces in the travel agency market, where CRSs have to compete to retain subscribing travel agents. It is the risk of losing these customers that creates the pressure on each CRS to aim to keep airlines participating at the highest level.

The functionality issue has already been addressed in the USA. In 1996 an amendment to the CRS rules was passed which prohibited the CRSs from including parity provisions in their contracts with participating airlines. In its report on the issue, the DoJ acknowledged that 'CRSs have substantial market power over the airlines, but generally not over the travel agents.'²⁸ It was concluded that the parity provisions reduced the incentives for CRSs to lower fees, to tailor their products, and to enhance the service provided.

The DoJ hoped that allowing participation at differing levels would allow the airlines to take full functionality in the CRS that has strength in a given region, and lower functionality in the competing CRSs. The Department of Transportation is currently analysing this issue, but made clear in an interview with the team that no major changes in the market have occurred as a result of prohibiting the parity provision. The dynamic of this process is likely to be similar to that outlined above in respect of allowing airlines not to participate at all in a CRS.

However, even if airlines did downgrade their functionality, the CRSs could alter the price balance between the levels of functionality. In other words, the gap between the prices of basic and full functionality within a CRS would narrow, to limit the incentive

²⁸ Department of Justice (1996), 'Computerized reservation systems contract provision, comments of the Department of Justice', Notice of Proposed Rulemaking: Computer Reservations System Regulations, Washington D.C., USA.

for airlines to take lower functionality. This issue relates to the second remedy, in that it is difficult to assess the 'reasonableness', or cost-reflectivity, of the CRS's prices. A possible solution for the airlines faced with such price increases would be to use competition law, with an allegation of excessive pricing.

7.1.4 Regional differences

The final option considered is to alter the Code to allow airlines to take different levels of functionality in different regions. As discussed earlier, the upstream market is currently a global market that is governed by global agreements between airlines and CRSs. The global nature of these agreements would need to be changed.

The objective of this remedy would be to allow airlines to take full functionality in a CRS where the CRS has a strong market position, and to take lower functionality in areas where it is weak. Low-functionality subscription by airlines affects the ability of a CRS to offer travel agents a competitive product if other CRSs are able to offer full airline functionality.

Therefore, for any CRS attempting to build market share in an area where it had a weak position, reduced airline functionality subscription in that area would be undesirable. Accordingly, CRSs could be expected to negotiate better deals with the airlines to ensure that they retained the airlines' full functionality in these regions. An airline could use any improved deals negotiated with one CRS to extract better terms from others. In this way, competition upstream in general could be stimulated.

The risk of this change is that it may operate contrary to its intended purpose by reinforcing the position of the largest CRSs in any particular country, potentially encouraging market sharing. If CRS terms continued to be negotiated on a standard global basis (ie, similar prices for similar service levels in all local markets), CRSs would not want to jeopardise their returns in their strongest markets by agreeing to worse terms in other markets. Hence, they may accept lower airline functionality in the smaller markets in order to minimise the profit impact. This would effectively signal to the incumbent that they were not serious about entering or vigorously competing in those markets where they are relatively weak. Whether this is a profit-maximising strategy depends on margins and the relative size of the different markets.

If CRSs introduced prices differentiated by region, a more dynamic competition process might result. In those markets where a CRS was relatively weak, it would have an incentive to offer lower prices to ensure participation at the highest levels, so as to be able to offer travel agents the best possible service (relative to the other CRSs). However, unless the threat of exiting (or downgrading participation in) the dominant CRS(s) in that region is real, the effect on airlines' total costs of using CRSs is unlikely to fall significantly, as they would only obtain good deals where they sold few tickets.

In addition, it is unlikely that the price reduction to airlines from not participating in certain regions would be particularly large. Having established a network in a region, the marginal costs for the CRS of operating its system are relatively low. The only reason that the price for a particular region might be high is if the CRS has sunk considerable costs in developing the network. In this case, selective withdrawal by airlines may raise cost-recovery problems, potentially increasing the cost for all airlines remaining in the region. *In extremis*, this could deter CRSs from expanding into new regions.

7.2.5 Conclusion

Any modifications to the Code do not address the key issue of CRS market power. Airlines would still be reliant on the CRSs as their main distribution channel, so the impact on the airlines of reducing functionality may be much greater than the effect on the CRS. This is particularly the case if travel agents are reluctant to switch between CRSs.

In sum, it can be concluded that revoking or modifying the Code may result in more flexibility in the upstream market and may underpin other remedies (described below). However, alterations to the Code (or its full removal) alone are unlikely to be successful in increasing competition in the upstream market, and reducing the significant market power currently enjoyed by the CRSs.

7.2 Monitoring the cost base

Under Article 10.1 of the Code, CRSs are obliged to charge cost-reflective prices. In addition, the Commission has found that payments to travel agencies are legitimate distribution costs:

given the close correlation between the level of incentive payments to subscribers and the extent of competition between CRSs in a particular market, the Commission is persuaded by the CRSs' assertion that incentives awarded to subscribers are distribution costs.²⁹

However, this statement was made four years ago, when the levels of payments to travel agencies were lower. Currently, the actual costs and margins of the CRSs are poorly understood and are very difficult to estimate from public-domain information. CRS prices are more likely to reflect costs if there is adequate knowledge of what these costs are, and some form of price-cost monitoring.

There are several forms of cost analysis that could be undertaken by the Commission, which differ in the level of intrusion:

- formal price regulation;
- transparent cost reporting;
- arbitrary price cap.

7.2.1 Price regulation

The strongest level of intervention is direct price regulation. In this scenario, the regulator sets the price for the CRS's fee schedule, and may also dictate how that price should change over time. Such a solution would involve the regulator undertaking a detailed review of the operating costs, efficiency, asset base and profitability of the CRS

²⁹ European Commission (1997), 'Report on the Application of Council Regulation NO.2299/89 on a Code of Conduct for CRSs, Proposal for a Council Regulation (EC) amending Council Regulation No.2299/89 on a Code of Conduct for CRSs', Brussels, July, COM (97) 246.

companies. It would require costs to be allocated across airline seat bookings and other travel services, such as train and car hire.

Having done this, the regulator would need to determine the costs that are appropriate for an airline to bear, particularly in relation to the costs of travel agent acquisition and remuneration. Given the dynamic nature of the market and changing cost bases, the study would have to be repeated regularly.

Such cost studies are commonplace in regulated industries, particularly for setting access prices for telecommunications, gas and electricity networks. They are also used to set retail prices where there is no effective competition.

An example of this, outside of the standard regulated utilities, is the full price regulation proposed by the UK Monopolies and Mergers Commission (MMC) in 1995 in relation to Yellow Pages. In this instance, the market was for classified advertising services, with Yellow Pages, a subsidiary of BT, controlling 84% of the market. The advertising rates charged had increased significantly over 10 years, on average between 1.5 and 3% in real terms, and high levels of returns on both sales and capital employed (40.8% and 134.3% respectively in 1995) were thought to be further evidence that competition was lacking.

The MMC recommended that prices be regulated according to an RPI - 2 formula. Analysis of the cost base and profitability of Yellow Pages was undertaken on the basis of information provided by the company. The figures were then compared with all major UK industrial and commercial companies, 15 UK printing and publishing companies, nine advertising companies and nine software companies. The MMC also carried out a more focused comparison with other suppliers of classified directories (eg, Thomson), suppliers of similar products and the four closest publishing groups. The investigation took 12 months.

The outcome of such a process should be a reduction in the CRS charges to airlines. This benefit is predicated on the assumption that existing price levels are considered too high and are not cost-reflective. Further, it is assumed that airlines would not be expected to continue to pick up the full costs of the travel agent incentive scheme. If these assumptions are incorrect, all solutions aimed at addressing cost-reflectivity will fail. The key disadvantage with formal price regulation is that it requires significant resources, the CRSs have an information advantage, and such investigations need to be repeated. All of this is costly and highly intrusive.

A further implication is that, if the regulator does not allow CRSs to recover certain costs from airlines, these costs must be recovered elsewhere or removed. Thus booking fees to other travel services may increase, and incentive payments to travel agencies are likely to fall. Indeed, CRSs may need to return to charging travel agencies for the services provided.

However, higher levels of competition in the downstream market would mean that this solution has the potential to result in more efficient outcomes. As CRSs compete for travel agency business, they would try to charge travel agents the lowest possible positive fee, to prevent switching to rival companies. There would also be incentives to make efficiency gains to reduce costs, allowing a CRS to lower travel agents' fees and gain retail sales at the expense of rival companies.

7.2.2 Transparency in cost reporting

Full price regulation is a significant regulatory intervention and one that many regulators hesitate to initiate. An alternative solution is to rely on self-regulation. This could take the form of requiring the CRSs to submit to regulators periodic (for example, every two years), audited cost studies to justify prevailing prices. Another way of encouraging more transparency would be to require CRSs to present directly to the airlines the underlying changes in costs that result in price increases, such as increased investment.

Such solutions are far easier to administer than full price regulation, but are also more straightforward to undermine. The likelihood of CRS costs falling for airlines is therefore far from guaranteed.

A solution similar to this was reached in the MMC investigation into the petrol industry in 1990. The regulators found that it was difficult to analyse the cost base in this industry, as petrol is a joint product and has to be produced with other petroleum products in the same process. This makes it impossible to decide how much of the total cost of production relates to petrol as opposed to other products. The MMC accepted the incremental cost analysis used by the refiners. This indicated the incremental cost of producing an additional amount of petrol without altering the level of production of the other products. The incremental cost was therefore made up of the extra crude oil required and any variable costs (chemicals and electricity) involved. The MMC suggested that the industry should be monitored on an ongoing basis according to a set of indicators, including the difference between the prices of crude (which was taken to be a good proxy of incremental production costs) and end-product prices.

Other examples can be found in the banking sector. Banks engaging in cross-border payments use transfers called interchange fees to balance costs between the sender and the receiver of funds, to limit double-charging and to facilitate fund transfers. Card-payment schemes also use similar fees to balance costs between the bank that serves the retailer and the bank that serves the cardholder. Competition concerns have arisen over whether these fees are set at an appropriate level.

The recent regulatory solution in the case of Visa was to introduce objective benchmarks against which to assess the fees and transparency.³⁰ To ensure transparency, Visa must submit its cost studies to the Commission, and they must be audited by an independent firm.

This follows a similar judgement with respect to Girobank schemes in the Netherlands.³¹ In that case, at the Commission's request, the banks in question decided that the amount

³⁰ Notice pursuant to Article 19(3) of Council Regulation 17. Case Comp/29.373—Visa International (2001/C 226/10), para. 11.

³¹ 1999/687/EC: Commission Decision of 8 September 1999 relating to a proceeding under Article 81 of the EC Treaty (IV/34.010—Nederlandse Vereniging van Banken (1991 GSA agreement), IV/33.793—Nederlandse Postorderbond, IV/34.234—Verenigde Nederlandse Uitgeversbedrijven and IV/34.888—Nederlandse Organisatie van Tijdschriften Uitgevers/Nederlandse Christelijke Radio Vereniging) (notified under document number C(1999) 2056).

of the interbank charge was to be reviewed periodically in the light of a report by an independent expert as to the cost of using the most efficient processing method. This was to be done immediately after the Commission's decision, and every two years thereafter. The purpose of the periodic review was stated to be to ensure that the interbank charge continued to be related to the level of most efficient costs. The Commission is informed of the independent expert's findings and has also reserved the right to make the results of the study available to business users of the processing system (albeit in the form of aggregated figures which do not permit individual undertakings to be identified).

The risks with such a system are that the regulated firms have much better information about their costs and can present (or limit) information to their advantage. External audit can help reduce this practice. An example of this problem is seen in the undertakings agreed with BSKyB by the UK Office of Fair Trading (OFT) in 1996. In order to assess whether BSKyB was pricing its programmes in an anti-competitive manner, the OFT required the broadcaster to account for its wholesale and retail activities separately. This accounting obligation was not successful, as it did not specify sufficient detail for the regulator to judge whether pricing was at the correct level.

Without in-depth knowledge of the industry, it can be difficult for the regulator even to ask the right questions of a firm. The more penetrating the analysis, the closer this option is to the first cost measure—formal price regulation. In the BSKyB case, the OFT has been reviewing these undertakings since March 2000, and, at the time of writing, had not made a decision. This is an indication of the resources required to address such problems adequately.

7.2.3 Arbitrary price cap

The final option is to set an arbitrary price for the booking fee charged by CRSs to airlines, and expect the remaining costs to be recovered directly from travel agents. This model implicitly assumes shared cost recovery, but does not require the regulator to undertake any cost analysis. As long as the contribution made by the airlines falls short of the total costs, then the CRSs must seek further funding from the agencies.

As discussed above, this improves the incentive structure in the industry and encourages efficiencies. The benefits of such an approach is that no cost study is required, and the competitive pressures from the travel agencies can be expected to ensure that costs are kept low. Airlines have a formal constraint placed on increases of their contribution to the CRS costs, and hence the airlines' obligation is capped, unlike the existing system.

This option does have clear difficulties, however. It may be (politically) difficult for the regulator to set the initial cap, given that both CRSs and travel agencies would be likely to complain that the system was unfair. This may result in the regulator having to undertake a general analysis of the cost base of the CRSs to quantify which costs are

'vendor-allocable', which are 'subscriber-allocable', and which are shared.³² Once this is required, this solution is again similar to full price regulation.

As CRS costs may alter over time, it will be necessary to revisit the level of the cap periodically. For example, if they reduce their cost base, the prices they charge to airlines could again exceed their costs. In addition, problems may arise over the recovery of CRSs' investment in new technology or in developing their systems to supply services that airlines want, but travel agents do not. Under these circumstances, getting the travel agents to pay for the investments is unlikely to be successful, and it is unlikely that such services would be provided at all.

Therefore, the imposition of a price cap would not be a one-off exercise, but would involve some degree of ongoing revision. The cap itself would have to be sufficiently flexible to ensure that investment incentives are retained for the CRSs' continued system development.

7.1 Introduction of market mechanisms

The least interventionist regulatory solution would be to facilitate a change in the structure of the operation of the market such that market forces have a greater effect. The objective would be to produce a market structure that was self-sustaining in the long run, and that would not need continuous regulatory involvement.

OXERA considered a number of options for improving the incentives within the market to produce this kind of solution. The example presented in detail below appears to be the most suitable in economic terms, and the most likely to fulfil the requirements detailed above. However, the practical issues related to its introduction have not been considered, and other alternatives may be available that address in whole or in part the same problems.

7.3.1 Subscriber-based pricing

An extension of the suggestion in section 7.2.3 that has more radical consequences is a shift towards subscriber-based pricing where the (arbitrary) price cap is effectively zero. In this scenario, the CRS costs would be borne by the travel agents through fees, while no charge would be applied between airlines and CRSs. Any products or services offered by the CRS which are specifically for vendor use (such as the advertising of the CRS system) would continue to be recovered through vendor charges. In essence, only those services provided by CRSs, where airlines had a realistic option of declining them, would be chargeable to airlines. The cost of all other services provided by CRSs would be recovered from travel agents.

³² This method was advocated in the SH&E study of CRS charging principles.

In this remedy, the reservation fees are simply seen as another element in the cost of the inputs that a travel agent needs to deliver travel services. The travel agent procures these services directly—as with communications services, computing facilities, etc—and recovers the costs either directly from customers, or from the supplier of the service (eg, airlines or hotel operators), through a commission.

The key advantage from such a shift is the improved incentives. Agencies use the CRSs more efficiently, as they bear the incidence of CRS costs. This has the potential to lower the number of speculative and fictitious bookings made.³³

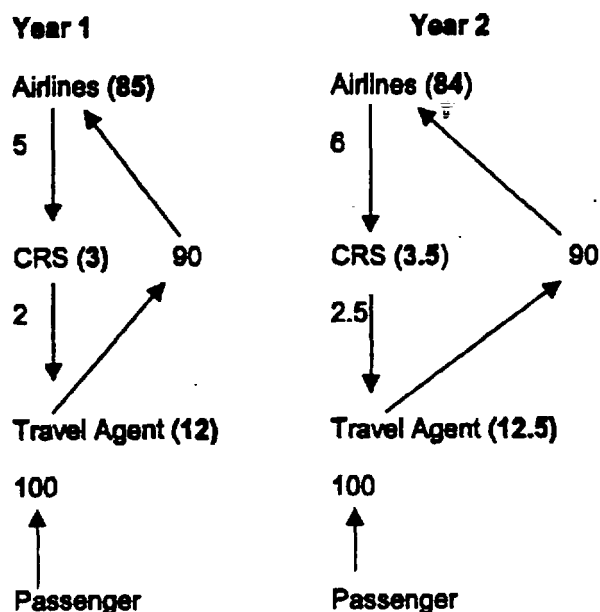
Subscriber-based pricing also encourages the travel agents to negotiate on price, as there is no direct cost pass-through. Travel agents would recover CRS costs from the airlines (or other travel-service suppliers) through the commission system. Airlines would pay travel agents a flat-fee commission per booking, based on the average level of CRS charges. This would provide an incentive for the travel agent to negotiate with the CRS.

If a travel agent negotiates successfully with its CRS provider, there is the opportunity to earn higher returns than its competitors by beating the average CRS charge 'yardstick' set by the airlines. This yardstick will be the portion of the overall commission that is intended to cover CRS costs. Similar yardstick incentive schemes are common in the regulation of the water sector and pharmaceutical reference pricing schemes.

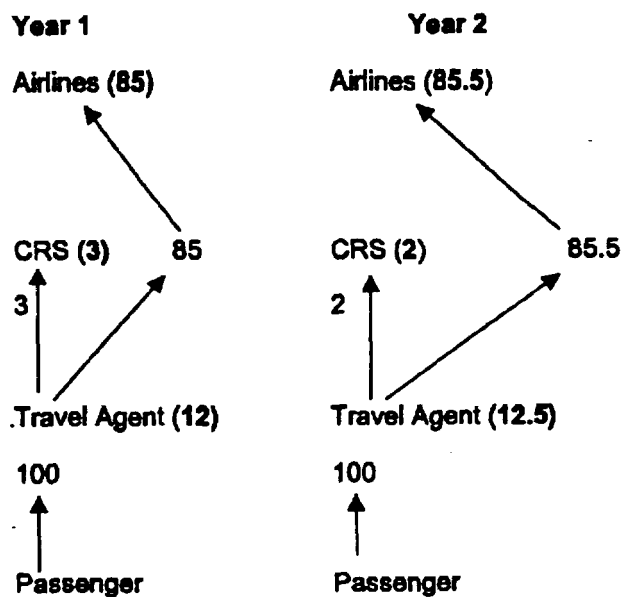
Another advantage of this proposal is that, when introduced, all stakeholders could be made no worse off. The benefits flow over time because the dynamic incentives are for agencies to put pressure on the fees charged by the CRSs. As airlines observe these declining fees, commissions can be reduced to share the benefits between airlines and agencies.

The proposed change in market structure is illustrated below, using the purchase of a £100 ticket at a travel agent as an example. The first scenario illustrates the existing situation, where the annual increase in CRS fees is used to finance a more lucrative incentive payment, and also results in higher CRS profits.

³³ Speculative bookings occur when a travel agent reserves seat inventory in anticipation of travel clients' demand. Fictitious bookings are those bookings initiated by a travel agent which are unrelated to any current or expected use by travel clients.

Scenario 1: Existing situation

In the subscriber-based pricing alternative, the travel agent is remunerated for the cost of CRS services by the airline in the form of increased commissions in year 1. In year 2 competition between the CRSs for travel agent business reduces the costs of CRS services incurred by the agents, and results in increased revenues for both travel agents and airlines:

Scenario 2: Subscriber-based pricing

There are two assumptions in the subscriber-based pricing model above. First, it is assumed that in year 1 all the CRS cost savings that are achieved by the airlines are passed back to the travel agencies in the form of increased commissions, so no party is made worse off initially. Comparing year 1 in the above two scenarios shows that the travel agent's commission increases from 10% to 15%, which maintains its net position at 12% (once it has paid CRS fees). If this were not to occur, travel agents may be forced to increase customer charges so as to recoup the cost associated with bearing some of the CRS charges.

The second assumption is that travel agents are able to negotiate lower CRS fees due to the threat that they will switch providers. The main feature of the model is that CRSs would derive their revenues solely from the downstream market. If the subscriber (travel agent) market is more price-sensitive, a switch to more refined CRS pricing may take place. CRS companies are likely to find it much harder to impose the yearly price increases that have been a recent feature of the market.

In addition, making travel agents pay for CRS services delegates the airlines' monitoring function to the agents. Currently, the airlines pay for the CRS services in large part, and are keen to ensure that CRSs are used efficiently and offer value for money. This is very difficult when the travel agents, which generate CRS demand, bear little or no responsibility for their actions.

Once travel agents directly incur the costs resulting from their choices, they will become more efficient in their CRS use. They are also likely to put pressure on the CRSs to introduce more transparent or disaggregated tariffs that allow the travel agents to monitor their CRS costs.

The success of such a scheme is predicated on the ability of travel agents to switch. As discussed in sections 2 and 4, there is some evidence to suggest that the threat is credible. In particular, CRSs pay large incentive payments to travel agents to keep their business, which would be unnecessary if the travel agent were completely 'locked in'. However, there is also evidence of switching costs. First, migrating bookings from one system to another is risky, with the possibility of potentially serious and costly errors. Second, where a travel agent uses the network and application software of the CRS, it needs to reconfigure its systems and may also have to train its staff how to operate the new system if it chooses to switch.

The ability of a travel agent to switch may also be constrained if one CRS has a dominant position within the national market. This has occurred in countries such as Germany and Spain, where Amadeus has over 80% of the market, and in the UK, where Galileo has over 60% of the market. In these markets, the other CRSs may not be able to offer similar levels of service and functionality, providing only a weak alternative to the main incumbent CRS.

The ease of entry into new national markets for the existing CRSs is unclear. As the main CRS technology already exists, the cost of moving into a new country is potentially low. However, the need to set up implementation, marketing and customer functions within that country may deter new CRS entry. There may also be limited potential to penetrate further into a new country if the majority of travel agents are locked into contracts with other providers.

A further problem may arise in the future. CRSs may vertically integrate into the travel agency market, lessening the competitive pressures. For example, Cendant, the new owner (subject to regulatory approval) of Galileo, has also acquired Cheap Tickets, a travel agency. Vertical integration resulting in common ownership of CRS and travel agents would remove the transparency of pricing in the market. The airlines would not be able to rely on the charges reported by the integrated travel agents as an accurate measure of actual CRS costs.²⁴ Airlines could rely solely on information from independent travel agencies, but if integration and consolidation were marked, this would be difficult. Such structural changes in markets have undermined similar procurement arrangements in the pharmaceutical industry.

Another problem with the subscriber-based pricing system is that travel agents may not be willing to pay for the CRS services that airlines wish to have provided. Airlines could still agree separate arrangements with the CRSs to pay for functionality and service upgrades that they wish to make available to travel agencies. Once airlines return to a positive charging arrangement with the CRSs, however, there is an incentive for the CRSs to inflate the costs of any airline-specific improvements, effectively cross-subsidising the cost of the downstream business again.

However, as with the discussion in section 5.1, once there is competition for travel agency business, the CRSs will want airlines to improve their functionality and may be willing to negotiate reasonable deals to ensure that an airline does not improve its offering in a rival CRS.

Subscriber-based pricing also has the potential to result in discrimination against smaller travel agencies. Large travel agents are able to negotiate more favourable booking fees with the CRS and better commissions with the airlines, because of their economies of scale. Smaller agencies may discover that they are bearing a disproportionate element of CRS costs, as the CRSs offer much better deals to the larger agencies. Without the ability to offer different commissions to different agencies, airlines may not increase commissions sufficiently to compensate the smaller agencies, leading to small travel agents being worse off and potentially non-viable.

Such discrimination also occurs in the current arrangements, with small agencies receiving significantly lower incentives than the large business agents, such as Carlson Wagonlit and American Express. Smaller firms will have a much weaker negotiating position with regard to the CRSs. By changing the structure so that agencies are paying, rather than receiving, fees, this discrimination is made significantly more transparent. The practical implementation of the subscriber-based pricing mainly depends on the effectiveness of prohibiting CRSs from charging airlines booking fees. There is a risk that

²⁴ Because the agent would no longer be independent from the CRS, it would lose the incentive to maintain cost control, and to monitor the CRS charges. The vertically integrated firm would gain from passing greater charges from the agent to the airline. This situation only becomes a major problem when a significant proportion of the travel agents in any one area is owned by CRSs.

CRSs will seek to undermine the subscriber-based pricing by increasing other charges, such as charges for data on number of bookings per region and per travel agent, or by introducing charges for services that are not covered by the Code or the subscriber-based pricing regulation. Where airlines can reasonably do without these services (either in total or from a particular CRS), the ability of CRSs to leverage their market position against airlines will be limited. However, if airlines are in a weak bargaining position in respect of these additional services as well, subscriber-based pricing will not improve their position, and may increase the incentives on CRSs to exploit any remaining market power that they have.

Finally, changing the structure in this way increases the potential power of the airlines against travel agencies. In the current system, agents have an alternate source of income and are not solely dependent on airlines. By introducing this subscriber-based pricing, travel agents bear risks arising from their CRS usage. Agencies may be vociferous in their dislike of such a change, which increases the control airlines have over agencies' income streams.

8. Implementing Change—The Political Approach

The original brief from AEA set out two objectives: in the medium term to change the relationship model between airlines, agents and CRS vendors, and in the short term to trigger action by the European Commission where CRSs are not complying with the Code of Conduct.

The two objectives are interlinked. However, there is no easy way in the short term to increase the airlines' economic bargaining power in relation to the CRSs. In addition, the problem that the Code is primarily designed to address remains (parent airlines using daughter CRSs to distort competition in either the airline market or the CRS market). However, this is not the main problem facing AEA airlines with respect to CRSs (which is about CRSs exploiting their market power with respect to airlines in general).

The analysis in sections 2, 4 and 5 demonstrates the uncompetitive elements of the current market structure and dynamics, and the need for change, providing a broad competition policy backdrop against which the more immediate issues should be considered.

8.1 Political and regulatory blockages

The present market structure has become blocked. The CRSs have been able to shelter behind the Code, refusing dialogue with the airlines, dismissing enquiries from the European Commission, and refusing to respect newly introduced provisions, such as those relating to group purchase of data, while at the same time building their businesses.

8.2 Unresolved issues

8.2.1 The German double-fee situation

This is a telling example of the inequities of the present structure of the CRS market. The Board of Airline Representatives in Germany (BARIG) has already been involved in (apparently fruitless) discussions with the CRSs and 2 roundtable-meetings initiated by the Commission ended without an effective solution.

8.2.2 'Group' definition for MIDT purchase

The CRS hostility to this provision was demonstrated by their taking the case to the European Court. However, despite the Court of First Instance judgement in December 2000, the CRSs appear to have refused to accept any group applications for data. This is a clear breach of the Code where the Commission should have acted more vigorously. It is still not clear when the Commission will propose modifications.

8.2.3 AEA's formal complaint on alleged collusion

On March 15th 2001 the AEA made a formal complaint to the Commission on the CRS fee notification. There is little indication that this complaint has been followed up, except with a holding reply on April 10th 2001.

This is potentially the most far-reaching and sensitive issue, but one which goes to the heart of AEA's grievances. The economic analysis herein provides the general basis for opening a procedure.

8.3 Formal review of the Code

The Commission has an obligation under the Code to investigate complaints and to 'initiate procedure to terminate infringement'.

9. Conclusion

This report has outlined in some detail the challenges facing the airline industry, in terms of both the economic uncompetitiveness and the political iniquities of the current computer reservations regime.

There is a strong case for changing the current regime to address the inadequacies of the current market structure and creating a structure that restores competitiveness to all parts of the system..

Prepared on 19 October 2001, by:



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EXHIBIT 10

The key to our low unit costs is the high productivity of our assets and our employees. Some of the factors that contribute to our low unit costs are:

- *We operate only one type of aircraft, the technologically-advanced Airbus A320, with a single class of service.* Operating a fleet of identical aircraft leads to increased cost savings as maintenance issues are simplified, spare parts inventory requirements are reduced, scheduling is more efficient and training costs are lower. Flying a single type of aircraft also allows our employees to become highly knowledgeable about the A320, thereby increasing their efficiency and productivity. A single class of service simplifies our operations, enhances productivity, increases our capacity and offers an operating cost advantage. In addition, the size of our order of A320s enabled us to reduce our aircraft acquisition costs through a volume discount.
- *We utilize our aircraft efficiently.* For the year ended December 31, 2001, each of our aircraft operated an average of 12.6 hours per day, which we believe was higher than any major U.S. airline. By comparison, Southwest reports that its utilization rate was 11.1 hours per day in fiscal 2001, which is recognized as the highest among the major U.S. airlines reporting this statistic. By using our aircraft more efficiently than other airlines, we are able to spread our fixed costs over a greater number of flights and available seat miles. We achieve high aircraft utilization in several ways. New aircraft can be safely scheduled to fly more hours each day because they are more reliable and require less maintenance than older aircraft. In addition, we operate a number of "red eye" flights, which enable a portion of our fleet to be productive through the night. Our aircraft are scheduled with minimum ground time to avoid unnecessary time spent at airport gates. Quick, efficient airport turns increase the number of daily flights per aircraft.
- *Our workforce is highly productive.* We take great care to hire and train employees who are enthusiastic and committed to serving our customers and we incentivize them to be highly productive. We believe that we have one of the most productive workforces in the industry. Our high level of employee productivity is created by greater fleet commonality, fewer unproductive labor work rules, a greater use of part-time employees compared to other airlines and the effective use of advanced technology. For example, most of our reservation sales agents are part-time employees who work from their homes, providing us better scheduling flexibility and allowing employees to customize their desired schedules. Our compensation packages are designed to align the interest of our employees with our stockholders. A significant number of our employees, including FAA-licensed employees, participate in our stock option plan. All employees, including part-time employees, are eligible to participate in our profit sharing plan and will be able to participate in an employee stock purchase plan after this offering.
- *We have low distribution costs.* Our distribution costs are low for several reasons. Unlike the major U.S. airlines, we do not use any paper tickets. Ticketless travel saves paper costs, postage, employee time and back-office processing expense. In addition, we believe passengers who book ticketless travel are more likely to book directly with the airline rather than through a travel agent. Direct bookings by our customers save travel agency commissions and computer reservations systems fees. For the year 2001, 92.6% of our sales were booked directly with us either through our reservation agents or on our website. Internet sales on www.jetblue.com are our least expensive form of distribution and accounted for 44.1% of our sales for 2001. We believe that our percentage of Internet sales is slightly above that of Southwest Airlines and well above that reported by most other major U.S. airlines.

New All Airbus A320 Fleet. With over \$175 million of equity capital, we have been able to acquire a fleet of new aircraft. Many new entrants in the airline industry during the last 10 years began flying with a fleet of used aircraft. By using our strong capital base to acquire a fleet of new aircraft, we have set JetBlue apart from most other low-fare airlines, both new and established. We currently operate 22 Airbus A320 aircraft, all of which were delivered to us new. Each aircraft is equipped with 162 leather seats in a

EXHIBIT 11

AA's EveryFare Saves TQ3 Clients 7 Percent On Average

MARCH 12, 2003 --

TQ3 Travel Solutions today said its participation in American Airlines' EveryFare program (BTN, Dec. 9) between Nov. 14 and Dec. 13 saved an average of 7 percent "compared to corresponding GDS published rates" for seven clients with varying volumes, policies and historical AA usage. Savings "ranged from as high as 15 percent to as low as 5 percent," the agency announced. The number of AA Web fares purchased also varied, said TQ3, "from 219 for a \$30 million client in an AA market with a policy encouraging non-refundable tickets to two transactions for a \$4 million client outside an AA market with no policy requiring or encouraging the use of non-refundable tickets."

TQ3 said AA Web fares purchased included Y and Q class fares that were 5 percent off published Y and Q fares as well as others in various markets that were an average of 15 percent lower than their published counterparts. "Where applicable," TQ3 said, "clients with an AA contract were allowed to use their corporate discount, as well as the lower Web fare for even greater savings."

EXHIBIT 12

NO. 67-194022-02

AMERICAN AIRLINES, INC.,	§	IN THE DISTRICT COURT OF
	§	
Plaintiff,	§	
	§	
v.	§	
	§	
FARECHASE, INC.,	§	TARRANT COUNTY, TEXAS
	§	
Defendant,	§	
	§	
SABRE INC.,	§	
	§	
Intervenor.	§	67 th JUDICIAL DISTRICT

INTERVENOR'S ORIGINAL COUNTERCLAIM

TO THE HONORABLE COURT:

Sabre Inc. ("Sabre"), Intervenor in this action, as Counter-Plaintiff, complains of Plaintiff American Airlines, Inc. ("American"), as Counter-Defendant, and for cause of action alleges the following by way of Counterclaim:

I. Incorporation of Allegations

Sabre adopts and incorporates by reference the allegations as set forth in its Plea in Intervention in this case.

II. Summary of Claims

Sabre's claims against American are simple. Sabre operates a computer reservation system (sometimes also referred to as a global distribution system or "GDS") that travel agents and others use to book air travel (among other things). American Airlines, like many other airlines, participates

in this system. This participation allows American to distribute its services and sell its tickets to and through travel agents and others who subscribe to or use Sabre's computer reservation system (these people are commonly known in the industry as "subscribers").

The agreement between American and Sabre (referred to customarily in the industry as a "Participating Carrier Agreement" or "PCA") requires American to make all of its air fares available in Sabre's computer reservation system. American has refused and continues to refuse to make a class of fares known as "web fares" generally available to all of Sabre's subscribers. American's refusal to provide these fares for sale to any of Sabre's subscribers through the Sabre computer reservation system constitutes a breach of the PCA.

Sabre is seeking damages for past breaches and is asking the Court to require American to specifically perform its obligations in the future.

III. Facts

On about September 22, 1998, American entered into a written contract with the Sabre Group, Inc., entitled "Sabre Participating Carrier Distribution and Services Agreement." Thereafter, on about July 30, 1999, the Sabre Group, Inc., changed its name to Sabre Inc.

The PCA obligates Sabre to distribute American's services through the Sabre computer reservation system. Pursuant to the terms of that agreement, American (referred to in the PCA as the "Participating Carrier") agreed that it had the following responsibilities, among others set forth in the following enumerated provisions of the PCA:

- 2.1 Participating Carrier, at its own costs, shall coordinate its reservations services with SABRE to provide as advantageous and uniform reservations services to all SABRE Subscribers as it provides through any other GDS. In addition, any improvements, enhancements, or additional functions to Participating Carrier's reservations services offered to end users of any GDS will be offered by Participating Carrier to SABRE

Subscribers on the same terms and conditions as are agreed to with such GDS. Such services shall include, but are not limited to, ticketing capability, passenger information, interim schedule change data, fare data, fare quotations, and procedural information. Seat availability on each flight will be on a segment or first closing basis, and shall be in accordance with the provisions of Article III of this Agreement.

2.4 Participating Carrier will provide SABRE Group, as rapidly as possible, with all revisions to its information concerning services provided to passengers, including interim schedule change data, fare data and fare quotations, and such other material that may be included in SABRE. Participating Carrier will not close its flights to SABRE Subscribers on a less favorable basis than it uses to close flights to users of any GDS. Participating Carrier will transmit revisions immediately by AVS messages. Participating Carrier shall not withhold from SABRE Subscribers in any country any fare inventory class made available by Participating Carrier to users of any other GDS in that country.

2.16 SABRE Group shall use reasonable efforts to obtain the fares and fare rules which apply to Participating Carrier's flights from industry fare suppliers. If SABRE Group is unable to obtain such information after reasonable effort, Participating Carrier shall promptly supply, upon SABRE Group's request, the information to SABRE Group by loading in SABRE. Participating Carrier agrees to give SABRE thirty (30) days advance written notice of any changes in their fare vendor. The information shall be provided on magnetic tape or other medium mutually agreed upon by the parties. Any changes or revisions to such fares or fare rules shall thereafter be regularly submitted on a timely basis to SABRE Group by Participating Carrier by way of the same medium. Notwithstanding the foregoing, Participating Carrier shall submit such fare information on at least as timely and regular basis as is used for any other GDS. For fares and rules not submitted to SABRE through an industry fare supplier, Participating Carrier agrees that it will not issue a debit memo to a SABRE Subscriber for any SABRE auto-priced ticket wherein the debit memo is a result of a fare change about which Participating Carrier failed to notify SABRE Group at least ten (10) days prior to the effective date of that fare change.

American currently offers, and for some time in the past has offered, certain fares on its website, AA.com, which are commonly referred to as "web fares." These web fares are generally the lowest priced fares offered by American to the traveling public. As is evidenced by American's position in this lawsuit, American attempts to restrict access to those web fares except to visitors to the AA.com website, and others with whom American has entered into other commercial agreements

with to obtain such web fares, such as Travelocity and Orbitz. Sabre is unable to obtain those web fares for the use of its subscribers from industry fare suppliers.

Although Sabre has requested that American provide its web fares to Sabre in a manner that Sabre can make those web fares available to its subscribers, American has refused to do so, and continues to refuse to do so. In failing and refusing to provide Sabre with the web fares, for use by Sabre and its subscribers, American is failing to perform its responsibilities and obligations pursuant to the terms of the PCA, including Sections 2.1, 2.4, and 2.16.

IV. Breach of Contract

Sabre has fully performed its obligations under the PCA. American has breached the terms of the PCA by wrongfully refusing to provide Sabre its web fares for use by Sabre and its subscribers.

V. Damages

As a result of American's breach of the PCA as set forth in the preceding paragraphs, Sabre has sustained financial harm and has lost some of the benefits to which it is entitled under the terms of the PCA.

VI. Specific Performance

Sabre has not repudiated the PCA and does not intend to do so. Sabre intends to continue to perform its obligations under the PCA. Therefore, Sabre seeks a decree from the Court requiring American to specifically perform its obligations under the PCA to provide Sabre access to American's web fares for use by Sabre's subscribers in the future.

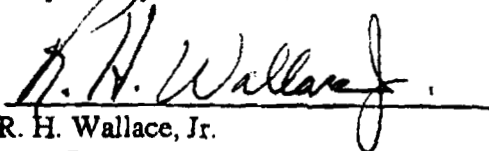
VII. Conditions Precedent

All conditions precedent have been performed or occurred.

WHEREFORE, Sabre, as Counter-Plaintiff, requests judgment of the Court against American as Counter-Defendant as follows:

1. Damages in an amount within the jurisdictional limits of this Court.
2. A decree requiring American to specifically perform its obligations and responsibilities pursuant to the provisions of the PCA to provide Sabre access to American web fares for use by Sabre's subscribers.
3. Attorneys' fees.
4. Costs of suit.
5. Other and further relief to which the Counter-Plaintiff may be justly entitled.

Respectfully submitted,



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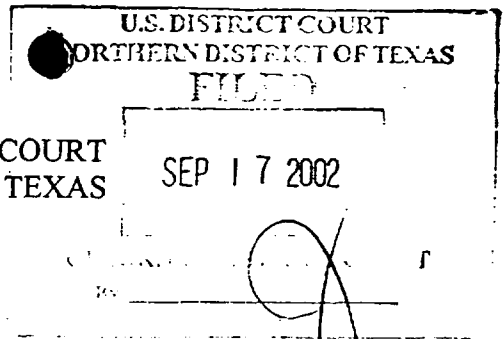
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**ATTORNEYS FOR COUNTER-PLAINTIFF,
SABRE INC.**

EXHIBIT 13



IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SABRE INC.,

Plaintiff,

v.

AIR CANADA INC.,

Defendant.

3-02CV2016-L

CIVIL ACTION NO. _____

PLAINTIFF'S ORIGINAL COMPLAINT

Plaintiff Sabre Inc. ("Sabre") hereby files this Complaint against Air Canada, Inc. and in support thereof states as follows:

THE PARTIES

1. Plaintiff Sabre is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 3150 Sabre Drive, Southlake, Tarrant County, Texas 76092.

2. Defendant Air Canada, Inc. ("Air Canada") is a corporation organized and existing under the laws of Canada with its principal place of business and home office at Air Canada Centre, 7373 Cote-Vertu Blvd. West, Saint Laurent (Montreal) H4Y 1H4, Quebec, Canada. Air Canada is not registered to do business in the State of Texas, although it does business in the State of Texas, including, but not limited to, operating air carrier services from Dallas/Fort Worth International Airport. Pursuant to the contract at issue in this dispute, Air Canada has agreed and consented to jurisdiction in the State of Texas in any dispute arising out of the contract.

JURISDICTION AND VENUE

3. Plaintiff is a citizen of the State of Texas and Defendant is a citizen of Canada. The amount in controversy exceeds \$75,000, exclusive of interest and costs. Accordingly, this Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1332.

4. This Complaint may be served upon Air Canada by and through service upon the Texas Secretary of State, as authorized by Fed. R. Civ. P. 4(h) and TEX. CIV. PRAC. & REM. CODE § 17.044(b). The Texas Secretary of State can serve Air Canada via International Registered Mail at Air Canada's home office, Air Canada Centre, 7373 Cote-Vertu Blvd. West, Saint Laurent (Montreal), Quebec H4Y 1H4.

5. Venue is proper in this District pursuant to 28 U.S.C. § 1391.

FACTUAL BACKGROUND

6. Sabre, among other things, owns and operates a state-of-the-art global distribution system ("GDS") used for air transportation, hotel, car rental and other travel-related services. Sabre markets the Sabre GDS to tens of thousands of subscribers worldwide. These entities – typically, travel agencies – use the Sabre GDS to, among other things, review travel availability for, make reservations on, and issue tickets for travel on participating foreign and domestic air carriers, which contract to participate in the Sabre GDS and to pay Sabre a fee for each booking made through the Sabre GDS.

7. Prior to July 2, 1996, the SABRE Travel Information Network ("STIN"), then a division of American Airlines, Inc. ("American"), together with other affiliated companies, owned and operated the Sabre GDS.

8. On July 2, 1996, STIN and other affiliated entities were consolidated into Sabre. Additionally, on July 2, 1996, American assigned and transferred its interests, rights, and obligations in contracts with participating carriers, such as Air Canada, to Sabre.

9. On or about July 31, 1990, Sabre and Air Canada entered into a Participating Carrier Distribution and Services Agreement, as amended from time to time thereafter ("the Participating Carrier Agreement"). Pursuant to various provisions in the Participating Carrier Agreement, Air Canada is required to provide schedule, fare and other data to travel agents and others who subscribe to Sabre so that reservations on Air Canada can be made through the Sabre GDS. Air Canada, in turn, is required to pay Sabre a fee for each reservation or "Booking" made through Sabre on its behalf.

10. Air Canada has failed to allow Sabre subscribers to book reservations for some of its flights, in breach of the Participating Carrier Agreement.

11. At all relevant times, Sabre has faithfully and fully performed its obligations under the Participating Carrier Agreement. All conditions precedent to the filing of the claims in this lawsuit and Sabre's entitlement to and recovery of damages from Air Canada has been performed by Sabre.

**COUNT ONE
(Breach Of Contract, Debt)**

12. Plaintiff realleges and incorporates by reference paragraphs 1 through 10.

13. At all relevant times, the Participating Carrier Agreement was a validly executed and enforceable agreement between Sabre and Air Canada.

14. Air Canada has not performed its obligations under and has materially breached the Participating Carrier Agreement.

15. As a consequence of Air Canada's breach of the Participating Carrier Agreement, Sabre has suffered substantial direct and consequential damages and is entitled to recover its damages, together with all applicable interest, in an amount to be determined at trial.

16. As a consequence of Air Canada's breach of the Participating Carrier Agreement, Sabre has retained the law firm of Gibson, Dunn & Crutcher LLP to represent it in this action and

has agreed to pay said firm's reasonable attorney's fees. Sabre is entitled to recover its reasonable attorney's from Air Canada pursuant to, *inter alia*, Texas Civil Practice and Remedies Code § 38.001 *et seq.*

JURY DEMAND

Plaintiff demands a trial by jury.

PRAYER

WHEREFORE, Sabre asks that Air Canada be cited to appear and answer, and that Sabre have judgment against Air Canada for:

- (1) Damages within the jurisdictional limits of this Court;
- (2) Reasonable attorneys' fees;
- (3) Pre-judgment interest as provided by law;
- (4) Post-judgment interest as provided by law;
- (5) Costs of suit; and
- (6) All other and further relief, at law or in equity, to which Plaintiff may be justly entitled.

DATE: September 17, 2002

Respectfully submitted,

By: 

John R. Crews

State Bar No. 00785529

Jon G. Shepherd

State Bar No. 00788402

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ATTORNEYS FOR PLAINTIFF SABRE INC.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SABRE INC.,

Plaintiff,

v.

CIVIL ACTION NO. _____

AIR CANADA INC.,

Defendant.

CERTIFICATE OF INTERESTED PERSONS

Plaintiff Sabre Inc. ("Sabre"), pursuant to Local Rule 81.1(a)(D) and Local Rule 3.1(f) hereby files this Certificate of Interested Persons.

The following persons or entities may have a financial interest in the outcome of this case:

Sabre Inc.

Sabre Holdings Corp., a publicly traded company and parent of Sabre Inc.

Air Canada, Inc.

September 17, 2002.

Respectfully submitted,

By: 

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